



Economic Study for the Film, Television, and Digital Media Sector in Ontario

Final Report

October 4, 2006

Important

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1. Executive Summary

Ontario has identified the Entertainment and Creative Cluster (E&CC) as one of the foundations for future growth in the province, a cluster which includes screen-based industries (comprised of Film, Television and Digital Media content production).¹

This report expands on the strategy for the sector described in *Leading Canada, A Partnership to Build Ontario's Film, Television and Interactive Media Industries, A Five-Year Strategic Plan* submitted to the Government of Ontario by an industry Working Group consisting of co-chairs from industry consortium FilmOntario, the CFTPA (Canadian Film & Television Production Association) Ontario Producers Panel (OPP), representatives from the Producers Roundtable of Ontario (PRO) and the New Media Business Alliance (NMBA). The purpose of this report is to assess the economic context of the screen-based industry sector, and develop an integrated set of recommendations that would create a vibrant, growing, and sustainable sector in Ontario.

Entertainment and Creative Cluster: a foundation for future growth

The Ontario government is strongly committed to innovation and the support of knowledge-based industry sectors as a foundation for future growth in the Province. The E&CC was identified by the Provincial Minister of Finance in 2005 as one of the three sectors that appeared to have significant future growth potential.²

For the purposes of this report, the E&CC broadly embraces the creative components of a range of entertainment, cultural, and media industries, including print product (e.g. books) and print media (e.g. magazines), the music sector, radio and television as media and their content production, built heritage and their collections, and live performance-based sub-sectors, like theatre.³ The

1 While "screen-based" formerly meant feature films exhibited on screens, the term here has the modern connotation of the "screen" a meaning which includes television sets, computers, and devices such as cell-phones, personal digital assistants (PDA), etc.

2 *Toward 2025: Assessing Ontario's Long-Term Outlook*, published in 2005 by the Minister of Finance, is the first-ever long-range assessment of Ontario's fiscal and economic environment produced by the provincial government. It is designed to inform Ontarians and those interested in Ontario's future about the challenges and opportunities that Ontario will face over the next 20 years. It identified three sectors that are expected to be of growing importance: information and communications technology; financial and business services; and the entertainment and creative cluster.

3 According to the "Toward 2025" report, entertainment and creative industries includes newspaper, periodical, book and database publishers; motion picture and sound recording; specialized design services; advertising-related services; radio and television broadcasting; pay TV and specialty TV and program distribution; performing arts; spectator sports and related industries; and heritage institutions. As a share of provincial employment, the arts and entertainment industries are expected to continue to rise steadily over the next 20 years from three per cent in 2004. In addition to employment and consumption trends within the current structure of the sector, the increasing convergence of culture and technology is expected to generate growth. A national hub for media and the arts, Ontario is a leading choice for headquarters of prominent broadcasting, publishing and performing arts institutions operating from their national bases in the Greater Toronto Area or Ottawa.

common theme is that the root of these sectors is the intellectual property (IP) that is protected by copyright to ensure the creators/producers can exploit its value.

In support of the above, Ontario strongly endorses the concept of “creative cities” for clusters as being an important drawing card for industry and business in general, providing an appealing environment for foreign and domestic individual and corporate investors across a range of industry sectors.⁴ The Clusters are an important economic motor in themselves – specifically the E&CC provides a highly conducive environment for the decision-making media business community to invest and locate in Ontario.

A study recently conducted in the United Kingdom (U.K.) on the economic impact of the U.K. screen industries examined the impact of a growth of production (in this study, in the form of increased demand from an export boost). It found that the regional economic development multipliers were highest in those regions when there is already a strong representation of screen-industry activities within the region as well as supporting industries – such as financial and business services⁵. If applied to Canada, such a finding would demonstrate that the highest economic benefit for regions would be strengthening an industry where there is already an existing base and where existing Centres of Excellence and the E&CC concept can be reinforced.

Screen-based content: an essential element of the Cluster

The E&CC is anchored by the screen-based sector partly because the kernel of the creative concept – the storyline – very often begins there. Traditional TV program and Feature Film content often spawn the creative concepts that flow into the interactive media – be they interactive games, an associated web site or application, a “mobisode” (content for mobile devices like cell phones), or other digital media application.

Additionally, content and applications are designed specifically for digital media (e.g. a game for an established console platform), and some digital media applications can be turned into a movie or other traditional content product. The key to success is a creative “storyline”.

4 The Creative Cities Project Team recently reported to the Premier of Ontario and Mayor of the City of Toronto that the film industry is amongst one of the key creative industries critical to building a creative city – however, as the report notes, ‘the city is on the cusp of a creative breakthrough, but the availability of capital to improve creative entrepreneurs will be critical to the realization of the city’s goal of becoming one of the top creative cities in the world.’ Page 21, *Imagine a Toronto... Strategies for a Creative Industry*

5 Cambridge Econometrics, *Economic Impact of the UK Screen Industries*, A Report Submitted to the UK Film Council and the National and Regional Screen and Development Agencies, 13 May 2005, page 90.

The central element of the Cluster is the IP that is exploitable to a widening array of platforms. Although the original IP may start as a book or play, most often it is the screen-based sector's creation of the storyline, format and brand that is the foundry for the wider E&CC. As the emerging media platforms develop to distribute the content, the screen-based sector will provide wider access to the creative output of the Cluster.

The key to a vibrant E&CC is unlocking the creativity of both the traditional and the new and innovative elements of the screen-based industry sector. In the new economy, spoils will go to societies that can most effectively integrate the screen-based sectors and optimize the output that they generate. The essential element to the screen-based sector is the exploitation of RIGHTS, the copyright ownership of the concept for especially the new platforms. It is the nurturing, development, and exploitation of all the rights by the creators and producers that drive the E&CC.

In order to create a sustainable industry at the heart of the E&CC, there is a need to think of the final product as a "cluster of products" as opposed to the traditional "Film, Television, or Digital Media." This approach will require a need to orient production companies toward this multi-platform thinking from the development stage, with the recognition that there is a continuous need for learning and information sharing in this rapidly developing field.

As the powerhouse of the entertainment and creative sector in Canada, Ontario should fully exploit its Film, Television, and Digital Media assets through new and emerging platforms. However, if the content producers are obliged to sell the "back 40" to finance the production, there will be little or no capture of all the proceeds from the investment in the original IP in the first place.

Ontario's well-established and diversified screen-based sector

Ontario has built a vibrant screen-based sector beginning with feature films and television production and most recently digital media. Over the last three decades creative Ontarians have responded to government incentives and market forces to develop a diversified infrastructure and skills-based workforce to become English Canada's chief "centre of excellence" in Film and Television, as well as capturing an increasing market share of interactive media. At the heart of this development is the production of content for the domestic market, for the Canadian broadcasting system and Canadian theatrical screens, and for Canadian high speed Internet subscribers. This core is at the centre of a vortex of rights creation and management across the Cluster. Ontario's potential genius is the interrelated activity across the different components of the E&CC.

In parallel, Ontario has taken advantage of its cost-effective infrastructure to attract foreign (principally American) production to Ontario locations. This "export" component of film and television production forms an important part of

the E&CC. It forms part of the overall ecology; it builds production management, business, technical, and creative skills and provides a continuity of opportunity for the creative and technical class of Ontarians working in the industry. It is a “manufacturing” model that pays for itself from the wallets of Hollywood. It provides the infrastructure from which Ontario can develop the capability to create and produce original concepts, and exploit the rights from these creations in domestic and international markets and across all platforms. The domestic and location production are intertwined, interdependent, and mutually supportive of the larger E&CC.

Breaking the cycle of the unprofitable project

While enormously successful in the development of an industry, government policy generally departs from the premise that we are talking about an emerging industry. Ontario has to look beyond this perspective and consider the industry as a mature one challenged by new technological and market forces as well as encompassing the emergent interactive media sector.

One general flaw in the current structure is that the production sector – for most of the screen-based sector that originates new content – is based on a subsidized model. While there are marketplace disciplines in the application of the various support programs and tax measures, the output will only grow if the subsidy grows – more dollars from the public sector (and more regulated demand from Canadian broadcasters) for domestic production equal more productions. However, in the financial modeling of the sector, we found that the screen-based projects on average lose money – even after the various support subsidies.

To address this fundamental flaw, this report is based on the need to “BREAK THE CYCLE”, and create a more self-sustaining, competitive, and market-driven screen-based sector. This report does not simply conclude that “more production financial support is needed.” Based on our current model, more production financing would only result in financing more production. Based on our analysis and research as part of this study, we have concluded that the sector needs a tool kit and additional financial resources to break the cycle and develop a more sustainable production/rights exploitation model. In writing this report, we recognize that the production community for Digital Media, Film, and Television will need to undergo a substantial “adjustment in mindset”.

The basket of measures proposed in this report are founded on the single drive to establish a more forward thinking, multi-platform industry that thinks of developing and exploiting intangible assets (rights) in Canada and abroad. If Ontario’s E&CC is to grow and Ontario’s interventions are to be leveraged, the screen-based sector has to accept this challenge and reconfigure its approach to creative concept development, production, and exploitation.

Moving from “manufacturing” to innovation and rights management

This report begins with the need to recognize the basic problem that encumbers Ontario’s screen-based producers – they are starved for cash. In practice, many Ontario producers often have to make numerous kinds of quality compromises to produce their projects. The sector basically operates on a manufacturing model. Producers undertake their projects for the production fee – and sacrifice any future revenue streams just to complete the financing of their projects. Furthermore, the project financing demands are such that producers typically forego some or all of their producer fees to complete the financial package required to trigger the funding for the project to go into production. Producer fees are tied up in the Federal and Provincial tax credits which materialize some 18 months later – and to access these funds for the production, producers must borrow on fairly onerous terms. In this manufacturing model, producers undertaking indigenous projects are “starved for cash.”

To move beyond the current situation, there are two basic issues. First, the industry needs to have flexible financial tools to move producers away from the cash flow crunch that cripples many of them in the process. Statistically, production companies operate at the very margins of profitability and cannot access financial markets for working capital. As a result, they are on a perpetual *“rush to production/sell out all rights/borrow to the hilt”* treadmill.

The second issue is a need to be able to move beyond the manufacturing model as the sole basis of operation. In the emerging platform era, far from confined to Canadian borders, producers have to become fully engaged in the rights business. They still need to operate within the producer fee framework, but they also need to move toward a position of fully exploiting the rights of projects they are producing. At present, some producers are able to hold on to the rights to foreign territories or other platforms, rather than foreclosing options by pre-sale or distributor commitments that enable producers to complete their projects. In the main, however, producers need to retain their rights longer in order to take full advantage of them – and many simply cannot afford to do so.

This transition to the “manufacturing PLUS rights management model” is not an easy one to make. It is not only working capital that is required. There is a need for a change in mindset of the producer to think beyond the traditional industry sector. There is a need to develop the Ontario capability to sell abroad and adopt a trading culture. Ontario producers should work on broader development “slates” so that concepts that come forward have survived a more competitive process. Producers have to develop their creative, marketing, and rights management capability, and/or partner with producers with complementary skills. Ontarians need to “hobnob” with their counterparts abroad – not only their partners in traditional sectors but also those operating in the new multi-platform world.

In addition, there must be stimulus to R&D, research and innovation. The E&CC sector is innovation-based – not in the traditional patent oriented “science and technology” sense, but rather in the “IP oriented” sense. There is a need for Ontario to enhance its brand as a generator of screen-based rights, and a full participant in the success of innovation in the IP sector.

Creating the tool kit to facilitate the transition

While the markets are quite different, it is interesting to look at the success of Quebec in feature films and television. With the right tool kit of policies and support programs, Quebec has carved out market shares of TV audiences and theatrical admissions that were not thought possible a decade ago. Quebec is now among the leaders internationally in terms of domestic success. The lesson for Ontario is that a strategic focus can become the fulcrum of necessary change.

Another demonstration of success, is the way in which policies in the U.K. have managed to convert a cottage industry of producers into a more formidable set of international players in the IP rights game. For example, the U.K. leads the world in the sale of television formats. Some U.K. producers have transformed themselves into such a sustained business that they have attracted private “City” financing, not only for individual projects, but also for corporate financing. In the U.K. producers have changed the game and the successful ones are global traders and take full advantage of rights across multiple platforms.

Ontario needs its own tool kit tailored to meet its own objectives:

- The tool kit should consist of financing support measures that leverage private sector financial institutions and provide Ontario producers working capital, so they can invest in development, innovation, partnership and collaboration, and in quality production.
- The tool kit should jump start producers to develop a broader range of multi-platform concepts, develop projects whose anticipated returns will break the traditional financing cycle, and ensure that these projects are well marketed.
- The tool kit should contain some infrastructure elements to foster research and innovation, help galvanize other clusters into supporting the new approaches, and build up the Ontario brand.

This report proposes specific integrated elements to form the basis of this tool kit including: financing instruments aimed at working capital improvement, research and innovation at the project developmental stage, demonstration projects with the capacity to break into the rights management as well as a fee-based model, and infrastructure support that encourages innovation, advocacy, and marketing.

Creating the instrument and setting the performance targets

To implement this new program, Ontario needs the right institutional resource to fully engage with producers, bankers, international sales agents and other stakeholders in the process of changing the culture of production in the Province. This report addresses this need and recommends how it should be accomplished – via a strengthened and upgraded Ontario Media Development Corporation (OMDC).

The strategic target is a screen-based sector where more projects should be profitable (always given that current measures of supporting project financing by the Federal and Provincial governments will be required in this sector). More profitable projects will lead to more working capital for companies – which will mean they can invest in concept development and multi-platform and/or international rights exploitation. The future state should be one where an increasing part of the revenue stream is from the exploitation of rights in foreign markets and for diverse platforms. It is one where the contribution to Ontario culture and society is unmistakable, but enjoys more sustainability and the ability to grow beyond the amount of subsidy provided by Government.⁶

Success measurement for screen-based industries should also be nuanced to take account of realistic expectations in each market segment. A greater focus on company viability and project profitability will ultimately be a key ingredient to the measure of success of this economic development program.

Recapping how financial barriers inhibit growth

The key issues in the financing of content productions are the following:

- Production costs are typically incurred and must be paid well before revenues are received, creating significant cash flow and working capital shortages for screen-based producers;
- Cash flow and working capital shortages which create inherent limitations on how content producers are able to optimize the value of all the rights flowing from the content. Without improved access to capital, the longer term potential for revenue growth and self-sufficiency will be limited;

⁶ This report focuses primarily on the issue of content production having commercial viability as its chief motivation. However, when discussing the screen-based sector, it is also important for the Government of Ontario to consider the cultural dimensions of the sector and the needs of society, as well as the benefits to society as a whole. The consideration of these cultural issues is largely outside of the scope of this report, and funding of primarily culturally focused projects and slates should therefore be considered independently of the funding needed to create a sustainable sector with strong levels of private sector involvement – the key issue discussed in this report.

- Cash flow and working capital shortages can also result in the starving of development activities, the R&D phase that is critical in the ultimate creation of high quality, marketable content; thus, such shortages further limit the revenue earning potential;
- To complete the financing of productions, producers must often defer, or potentially not recover, significant portions of their production fees. The current financing model ties up their funds in single productions for a longer period of time. This inhibits producers' abilities to develop "slates", which in turn limits overall industry capacity; and
- The lack of working capital and cash flow means that there is little or no risk capital for emerging platform innovation or to explore new markets and potential new revenue streams, or business models that arise from ongoing advances in digital technology and content delivery mechanisms.

The design and funding of the right tool kit of measures is essential to effectively address these issues. It is necessary to create an environment that will enable the screen-based content creation industry to grow in an economically viable and sustainable way. This implies a refocusing of government intervention around the strengthening of this particular segment. Production companies will then be in a position to generate more private investment for innovation and growth activities.

By itself, increased government funding is not enough. Content creators must also be able to realize more revenue from the sale or licensing of copyright of the materials they create. This market imperative implies the need for increased volumes of better quality content, new cross-platform revenue streams, and more aggressive and effective marketing both within Canada and on the international market. The tool kit should be designed to induce this behavior.

Creating an integrated tool kit

To achieve these outcomes, this report recommends a series of integrated government initiatives that working together will assist the industry in generating higher volumes and increased revenues. The proposed tool kit initiatives build on Ontario's existing support measures, including the partnership infusion of extra funds announced last year.

These recommendations are designed to create an internationally competitive industry by addressing each of the issues contributing to the underlying industry cash flow, working capital, and profitability issues. To achieve this fundamental shift, it is proposed that each program be in place for at least five years, with a re-evaluation to occur at that time.

The specific tool kit instruments we have recommended are itemized as follows:

Cash flow support:

- **Early Stage Loan Guarantees:** to bridge the crucial gap between project green-lighting and actually receiving the interim and project financing from end users, government agencies, and tax credit proceeds;
- **Interim and Gap Financing Subsidies:** to improve working capital and cash flow by shouldering some of the onerous provisions of such private financing;
- **Tax Credit Hold-back Loan Guarantees:** to ensure that a producer has access to his/her development fees prior to the release of the hold-back by the interim bank lender on tax credits;
- **Early Tax Credit Payment:** to address the tax credit payment lag – typically about 18 months - by bringing forward payments that producers can expect from tax credits:
 - This measure could be implemented as a one time budget expenditure, whose result would be beneficial to producers every year afterwards.
 - Because of the relatively high cost of such a measure (bringing forward 18 months of some \$100+ million in tax credits), an alternative would be to subsidize the producers' interest costs of financing tax credit payments on a recurring basis.

Direct Support for Screen-based Content Creation:

- **Content Creation Fund:** to help create a “critical mass” of profitable production activity by expanding the current OMDC Film Fund into a cross-platform creation fund. This fund would invest in the three stages of the concept-to-market cycle for model projects:
 - Development slates that reflect the new cross-platform reality;
 - Production financing for quality projects that demonstrate evidence of strong market appeal; and

- Marketing and promotion to ensure the full exploitation of all rights.

Sector-wide Infrastructure Investment:

- **Research & Innovation:** to develop new business models, identify ways to exploit new and emerging content delivery platforms, and develop new markets for Ontario content;
- **Advocacy:** to advocate for the alignment of Federal funding programs to the new Ontario model and support Ontario's centre of excellence in the screen-based sector; and
- **Marketing:** to attract both indigenous and foreign service productions, and to promote Ontario-produced content both domestically and in foreign markets.

As indicated earlier, to effectively operationalize this new tool kit there will be a need to bolster the OMDC through an enhanced mandate and staff with thorough grounding and experience in industry. We also recommend establishing an Industry Advisory Committee to work with the Ontario Government and the OMDC. This is critical to leveraging sector knowledge in terms of decision making and program design.

Aiming at more profitable projects

Taken together, this tool kit will promote innovation, new revenue streams, and higher quality productions, thus resulting in higher overall revenues per production dollar. In pragmatic terms, we propose that this new funding be targeted towards the more commercially viable projects that are expected to generate revenues 20% higher than the current industry average.

Although it is impossible to determine *a priori* the success of any project, there are corporate and project attributes that should provide acceptable indicators of the revenue target. Our financial models indicate that at this level of revenue and normal government support, the industry will be positioned to grow and prosper in a sustainable way, generating more jobs and revenue for the Ontario economy.

Modeling the impact of the tool kit on screen-based activity

To understand the current financial state of the industry, and the impact of our proposals on its future financial state, we created an estimated or “Pro Forma” Net Income model.⁷ Key points to note in the Pro Forma model include:

- **Current State:** The current state of the industry reflects overall losses on domestic production in Ontario. As mentioned previously, while there are profitable productions, on average productions lose money. While the level of government support relative to other jurisdictions is a major contributor, a material improvement in the revenue/production cost ratio also needs to be generated in order to achieve a viable sustainable industry.
- **Impact/Cost of Tool Kit:** The projected impact following implementation of the recommendations regarding the industry tool kit shows a material increase in production spend and improved marketability of both new and existing production volumes. The higher volumes generate additional tax credits and other public funding under existing programs, and the improved profitability also contributes to higher levels of private investment. Using our illustration of the model (shown in Appendix B) the estimated benefits to the province, over a five-year period are:
 - An increase in direct employment of 7,259 person-years
 - An increase in indirect employment of 11,559 person-years
 - An increase in Gross Provincial Product of \$1.27 billion

Based on our illustration model (shown in Appendix B) the cost to the Government of Ontario, net of tax revenue effects, over a five-year period, is estimated at \$84.5 million. This is based on a gross annual cost to the Government of Ontario of \$44 million. For a breakdown of this amount, please refer to Appendix A, Figures 2 and 3.

Given that our model is only directional in nature, we have not attempted to project a net income view of the industry five years out. We have also not factored into the model the possible new revenues that would accrue from exploiting cross-platform rights. We would expect that the benefits of these programs will be self-reinforcing, and that the profitability profile of the industry will continue to improve each year. Therefore, these proposals provide a roadmap for the Government of Ontario to achieve its objectives for this industry.

⁷ To create this estimated model we leveraged several key sources of data, and augmented this with estimation and extrapolation techniques where reliable data was not available. Therefore, the model should only be considered as a directional indicator, not as a precise measurement of the industry. The model does not contain any audited financial information or data, and should be read as such.

2. Introduction

2.1. *Background to the Study*

The Government of Ontario has long been in the business of stimulating the development of the Film and TV production sector. Through the earlier Ontario Film Development Corporation (OFDC) and the incentives established to support Ontario production (one version was the Ontario Film Investment Program – OFIP), Ontario has been a player of influence in the production sector. In recognition of the potential synergies across industries, OFDC became the OMDC, and migrated to a labour-based tax credit system to support Ontario-based production projects. In recognition of the importance of the U.S. originated production being shot on Ontario locations, this tax credit system was also designed to assist service-based production.

In late 2004, the Government of Ontario announced a significant increase in its domestic and foreign film and television tax credits, and removed the cap on the Ontario Computer Animation and Special Effects tax credit (OCASE). As well, the Government of Ontario announced significant commitments to the Canadian Film Centre and Toronto International Film Festival.

In 2005, the Ministry of Finance published the report “Toward 2025: Assessing Ontario’s Long-Term Outlook” identifying the E&CC as one of three industrial clusters expected to be of increased importance to the province.⁸ The publication of this Long-Term Outlook for the Province was the first-ever long-range assessment of Ontario’s fiscal and economic environment produced by the provincial government. “It is designed to inform Ontarians and those interested in Ontario’s future about the challenges and opportunities that Ontario will face over the next 20 years”. It identified three sectors that are expected to be of growing importance: information and communications technology; financial and business services; and the entertainment and creative cluster.

In December 2005, the Ontario Minister of Culture recognized the concerns of the industry and invited representatives of the Feature Film, Television and Digital Media sectors to participate in roundtable discussions on the future potential for the industry.

To respond effectively to Minister Meilleur, a Working Group made up of representatives from the CFTPA, the OPP, the PRO, the NMBA and industry consortium FilmOntario consulted widely with industry participants in Ontario and came to a consensus regarding the key issues confronting the Sector.

⁸ Queen’s Printer for Ontario, “Toward 2025: Assessing Ontario’s Long-Term Outlook, p.41.

Together, the Working Group created a unified position on how the screen-based sector could help grow the E&CC, and formulated a 5 Year Strategic Plan which was presented to the Government of Ontario in March 2006. As a follow-up to this report, the Working Group commissioned this economic study to help flesh out the strategic plan and identify the benefits of its implementation.

During the 2006 Budget, the Ontario Minister of Finance recognized the importance of the E&CC, and highlighted it as one of the Government's key priority sectors for investment. To this end, Minister Duncan announced an extension of the 18 per cent film production tax credit until March 2007, an expansion of the tax credit for small digital media businesses to 30 per cent from 20 per cent, and the creation of an E&CC Partnerships Fund that will provide \$7.5 million over three years to promote the cluster's development as well as cooperation among industry leaders.

Overall, the Ontario Government has shown its ongoing commitment toward building an E&CC, and its grasp of the intricate and complex relationship between the digital media⁹, location or service production, and domestic production elements of the sector. The Government of Ontario recognizes that participants in the industry are interconnected, and that the industry as a whole relies on the strength of its sub-sectors. This is reflected in the fact that people and production companies are moving more frequently across differing segments and media.

There is a growing need for flexible support mechanisms that focus on growing the economic sustainability of the industry rather than on increasing output based on the historical model. In particular, the long term vision is to move the screen-based sector within the E&CC toward greater use of intellectual property rights to generate revenue. To a large degree, this approach is dependant on having properly financed companies that are able to leverage innovation and multi-platform opportunities. To this end, the Working Group is proactively working with the Government of Ontario regarding follow-up to its 5 Year Strategic Plan.

⁹ For the purpose of this study, "Digital Media" is defined as electronic media which enables entertainment, information and educational content to be accessed across multiple platforms including traditional platforms such as film screens and TV, and also including computers, gaming consoles and mobile devices such as cell phones and Personal Digital Assistants. Digital Media may be linear where the user views content without interacting with it or interactive where the user creates their own experience by interacting with the content.

Digital Media participants may be broadly broken into two sub-groups: Content Creators and Content Enablers. As the name suggests, Content Creators are primarily focused on the creation or adaptation of content digitally for entertainment, information or education. Content Enablers are primarily focused on the manipulation of content to enable distribution and where appropriate interaction across multiple platforms. Both of the above sub-groups are potentially integral to successful projects.

2.2. Scope of the Study

PricewaterhouseCoopers in association with Nordicity Group Ltd. were commissioned by the Working Group to conduct an economic study to build on the information and recommendations included in the Strategic Plan, and:

- Identify how best to target incremental public support and use any new public funding to leverage additional private sector financing;
- Set out the economic business case for additional government funding and support for the industry; and
- Provide creative program design ideas for making the transition to a more sustainable screen-based sector.

2.3. Sector Overview: Situation Assessment

To determine the most appropriate use of available funds and help propel the Sector into a new era of innovation, economic growth, job creation, and international recognition, there must be a common understanding of the current situation and challenges facing the sector. The sector is inherently complex, and there are a broad range of challenges facing those in the industry (e.g. marketing, financing), each of which will play an important role in the overall success of any new initiatives. This section presents an overview of the sector and its challenges and opportunities, and frames the discussion of further sections in the report that delve into specific areas currently presenting challenges for sector participants.

Before the arrival of New Media, the Film and Television production sector had developed into a major economic force over the last few decades in Ontario and in some other centres in Canada. New Media is by definition new, with rapid growth prospects. While some business models within the cluster are taking shape, New Media is still a very young part of the E&CC.

Economic powerhouse as a sector

To put the screen-based sector into perspective, it is important to note that Ontario's volume of production in 2004-05 fiscal year was \$544 million in domestic production and \$521 million in foreign location production.¹⁰ That is over \$1 billion in economic activity, and it does not account for the New Media sector, whose data is less robust. This sector now employs some 49,100 people directly or indirectly¹¹, a figure which does not include the delivery sector, such as

¹⁰ Association of Production Funding Agencies, of which OMDC is a member.

¹¹ Profile 2006, produced by Nordicity Group Ltd. and commissioned by the CFTPA and APFTQ.

broadcasters, cable/satellite/DSL distributors, and movie exhibitors and distributors.

Screen-based sector's value chain

Although it varies for each sub-sector, the value chain of production can be broadly divided into the following components:

- Concept development (e.g. scenario storyboard, book option, draft script);
- Development (e.g. principal creative, location, foreign partner/buyer, financing);
- Production (e.g. principal photography/location shooting, software development);
- Post-production (e.g. editing, application testing); and
- Distribution (e.g. marketing, promotion, festivals, sales).

There has developed a range of Federal, Provincial, and Municipal government measures for each part of the value chain, including: Canada Council or Telefilm funding of script writing; project financing support by the Canadian Television Fund, Telefilm, and most recently by OMDC, or private funds; tax credits based on labour expenditures by Federal and provincial agencies, including Ontario; marketing and distribution support by Telefilm and OMDC. The Federal and Ontario governments also directly finance public broadcasters, namely the Canadian Broadcasting Corporation (CBC) and TV Ontario (TVO) / TV Ontario French (TFO).

The market revenues and private financing components include Canadian broadcasters through investment and license fees, Canadian cable/satellite providers through contributions to the Canadian Television Fund (CTF), feature film distributors, and New Media distributors or platform manufacturers (for game developers). The Federal regulator, the Canadian Radio-television and Communications Commission (CRTC), complements the financial assistance through Canadian content regulations, Canadian programming expenditure commitments, and significant benefits stipulations arising from broadcasting acquisition transactions. The result is a stimulus of the demand for Canadian programming, including programming that has a significant interactive component (e.g. the Bell New Media Fund).

Ontario's screen-based support mechanisms

Ontario's commitment to screen-based industries is mainly through tax credits for completed productions in film, video, and digital media. Tax credits for both location production and indigenous production amounted to \$106.6 million in 2005-06. Since these credits are labour-based, there is a direct correlation to the amount of spending in the provincial economy, so there is a direct return on the

annual investment on tax credits by the Province. In addition to the tax credits, the Province of Ontario also funds two network television channels, TFO and the English language education channel TVO. Productions for these channels represent an opportunity for Ontario creative companies.

As indicated earlier, Ontario evolved from investments in productions to a tax credit system for supporting Ontario-based productions. To a limited extent, however, Ontario has returned to directing funds toward the financing of projects, as has been the practice in other provinces. The amount is relatively small - about \$1.1 million in feature films last year and projected to grow to \$3.5 million this year. OMDC also spends on various infrastructure support services, mainly marketing, research, and the encouragement of partnering with other components of the cultural sector. Major production location centres, Toronto in particular, have supportive policies to facilitate the use of locations within the city.

Ontario's screen-based sector centre of excellence is vulnerable.

This support infrastructure has led Ontario to spawn the highest concentration of production companies in Canada. Six of the top 10 Canadian production companies – all but one with over \$40 million in production last year – are based in Ontario.¹² Though the figures are not as available, there is also a high concentration of New Media firms in the Province. These production companies invest their own energy and a considerable amount of deferred production fees to complete the financial structure to pay for the production.

Despite an obvious success story, these production companies operate on a precarious basis. They are typically obliged to put up their own fees as equity, as well as in many cases to finance projects in part through personal mortgages on principal residences. Unfortunately, this financial condition leaves Ontario producers for the most part under-developed and with a short term focus. It compromises the quality of productions, diminishes the number of projects that can be carried in the development stage, and inhibits innovation and cross-platform investment.

Even the more successful companies, those which have reached a stage where they can produce several projects concurrently face continual challenges. They may have developed good relationships with banks and therefore obtain good credit conditions. They may have diversified into ancillary functions like production facilities, distribution, and merchandising; they may have attracted the business affairs personnel necessary to seek out and negotiate complex cross-platform arrangements; they may even have developed value from their libraries (i.e. rights for exploitation). Despite these measures, they are usually unable to

¹² In descending order of total value of projects: Alliance Atlantis, Don Carmody Productions, Nelvana, Decode Entertainment, Shaftesbury, and Barna-Alpert Productions: Playback, May 15, 2006

attract outside capital into their companies from investors as is typically seen in other industry sectors.

International recognition of emergence and value of cross-platforms

While the pundits have been forecasting “gold” in the hills of New Media for some time, until recently it has not materialized in the commercial marketplace. There is a growing global recognition that the future of content in screen-based industries lies in its cross-platform applications. The Internet is proving a commercial success for sites that can attract millions of hits and click throughs – of course led by the search engines and user generated content sites (e.g. MySpace, Youtube, Digg). The development of user participation vehicles (interactive games, evolved chat rooms, etc.) enables TV programming franchises to extend the value of their rights. Episodes tailored to the Net, or to mobile distribution, are also ways of adding to their revenue potential. The Internet as a viral advertising tool to generate more loyalty, exposure, and usage can translate into more revenue from multiple sources.

Ontario is not alone in identifying New Media as a way of achieving more economic growth and domestic cultural enrichment. A stable of risk taking entrepreneurs is a perfect foundation for gaining entry into that world. However, the particular structure of production companies in Ontario (and Canada) makes them less able to join in the development of New Media. Their financial precariousness will inhibit Ontario screen-based content providers from pursuing the new opportunities. The danger for Ontario-based companies is that they could fall behind, and not take advantage of these future opportunities.

This danger is compounded by the vulnerable nature of Canadian content in broadcasting. As more of the potential revenue streams fall outside of the purview of the CRTC, even the stability of the current production financing will be threatened over time. While television will not disappear¹³ there will be more unregulated sources of revenue that broadcasters will be expecting to exploit. This overarching trend provides further impetus for developing measures that can strengthen Canadian production companies in the screen-based sector.

Vision to vault ahead and power the broader E&CC

The vision for screen-based production companies is to be relatively ahead of international rivals in the development and exploitation of content in this new era. The U.K. has succeeded in developing production firms that do exploit other markets and other platforms, and now attract outside investment. The opportunity for Ontario is to achieve a measure of success of the same kind, albeit scaled back to the Provincial (and national) economies.

¹³ See, for example, conclusion to that effect articulated in the Future of Television Green Paper published at the Banff Television Festival in Jun, 2006, prepared by Nordicity Group Ltd.

This vision fits with Ontario's identification of the E&CC as a growth driver of the future. The screen-based sectors form a critical part of that cluster, as they are behind much of the exploitation of content-based IP. Ontario has competitive advantages in this Cluster because it is the centre of much of Canada's English language national media – newspapers, magazines, broadcasters, and advertising production. It is also the centre of cultural production in addition to film – book publishing, music production, live theatre and the arts – and of built heritage and its contents. Major distributors are also strong in Ontario – from film and rights distributors to the larger cable, telephone, and satellite operators. Hence, the “centre of excellence” label of the E&CC is well merited, and well represented among both the creators and the producers.

Rethinking the provincial mechanisms

While the provincial interventions in screen-based industries so far have been effective in the current production model, they are not as appropriate for the production and rights management model. New types of intervention are required so that the vision can be realized. These interventions should be designed so that they encourage production companies to take innovative approaches and to take risks that will position them into the broader global markets of cross-platform exploitation. As well, the initiatives should include infrastructure support for innovation, market development, and brand development. To achieve the E&CC vision, stronger companies are required who can successfully build a trading culture and financial strength, and who can secure private investment.

In 2005/6, OMDC provided \$2,725,000 in direct support for Feature Film and \$425,000 for television, including direct funding for development, production, and export development. In addition, OMDC provided \$613,000 of direct support for the interactive digital media sector.¹⁴

Each of these measures will be examined in more detail in the following sections. For each set of measures, the needs are identified and recommendations made. There is also reference to experience in other jurisdictions where relevant. Finally, for each recommendation the benefits and costs of implementation are identified and estimated.

¹⁴ Unaudited 2005/06 results provided by OMDC.

3. Improve Corporate Working Capital - Financing

The following sections outline the typical issues the screen-based industry faces around production cash flow, including: Early Stage and Interim Financing, Gap Financing and tax credit cash flow issues.

3.1. *Early Stage and Interim Financing*

Situation

Film and television producers and their associated digital media partners often face high cash flow requirements during the time after receiving the “green light” for a project. Particularly with respect to television productions which have tight deadlines, producers are forced to move into production before all the approvals are obtained for the release of their interim financing (i.e. the “long form contract”).

Financial lending institutions (i.e., banks) provide interim financing to cover the time before the project’s financing partners release their funds, and the time it takes for the Federal and Provincial governments to process, vet, approve, and pay the tax rebates that are built into the financing structure of productions. However, the major financial institutions will not generally advance funds until all the key provisions in the production financing contract are met, which can be several weeks/a few months in a critical period when the producer should be devoting all the attention to the production itself. Even when they do sign off on interim financing at reasonable lending rates, banks charge the producer a set-up fee and all external legal fees to cover the risks of doing business in this field.

For digital media content creation companies in Ontario, the top three sources of financing for the development of intellectual property are: 1) company cash flow, 2) friends and family, and 3) the provincial tax credit.

With regard to the tax credit, when producers obtain interim financing specifically for tax credits, they are using financing to bridge their cash flow for the 12-18 months from the time they need cash for production to the time they receive the tax credits. Lenders typically will only lend 85-90% of the estimated value of the tax credits as a contingency against the tax credits being less than estimated. The result is that producers typically have to obtain other sources of financing to cover this 10-15% “holdback” of tax credit financing.

Needs

Screen-based producers in Ontario need access to more financing options for interim financing, and for the development of early stage interim financing

vehicles. In effect, there is a need to reduce the time it takes to secure interim financing.

Currently, as previously described, financial institutions need a signed “long form” contract between the producer and the broadcaster, film distributor, or other agency before releasing funds. This document can take months to complete. The cost of such financing also needs to be reduced. At present, early and interim financing usually incurs the following fees: a “set-up” fee to the financial institution, and the financial requirement that the producers pay both their own and their bank’s outside legal fees. Typically, set-up fees paid to the financial institution are 1% of the loan, while legal fees typically range from \$15-20,000.¹⁵ These fees divert a substantial amount of production spending from the screen to financial and legal intermediaries.

As part of the overall interim loan program, there is a need to consider implementing a program to address the tax credit so the entire tax credit amount is received when it is most beneficial.

Inherent in the financing issue is also a need to counteract the orientation of producers to finance only the main platform for content provision (i.e. the broadcast program or the feature film), as opposed to financing all potentially viable platforms. If funding were available for the latter, it could lead to a variety of quality saleable products and an increase in copyrighted content which could fully leverage a concept’s potential. For example, the fact that “friends and family” are significant sources of financing for the development of digital media intellectual property indicates that more formal financing mechanisms are needed to support digital media content creation.

3.2. Gap Financing

Situation

Gap financing is essentially a loan to the producer, based on the prospect for selling a production in territories where it has not yet been sold. There are few institutions offering gap financing to Ontario projects, as few institutions have the capacity to evaluate the market potential of a project in terms of offshore sales potential. Due to this lack of access to gap financing, many Ontario producers must exchange rights for certain territories in order to secure the pre-sales agreements and/or distribution advances necessary for funding production of their projects. Such arrangements can translate into a “ceiling” on the foreign earnings potential for their projects, which in turn can reduce the potential source of future working capital for the company.

15 Nordicity Group Ltd., Study on Completion Guarantees and Financing Tools in the Audio-Visual Industry, report prepared for the Department of Canadian Heritage, April 2005, p. 64.

Needs

Ontario producers need more, and less expensive, options for Gap financing so that producers can retain rights for more territories during the early stages of production. Based on this scenario, they can license/sell content at a point when the true value can be optimized, thus increasing the returns on their productions. Such financing would also be critical for producers to be able to pursue a multiple platform approach to product concepts, whereby they could leverage content across new platforms to increase their output, ownership, and take advantage of all potentially viable opportunities rather than the focusing solely on the traditional platform.

Experience of Other Jurisdictions

Feature Film, Television, and Digital Media producers typically need to secure financing to complete projects. However, in some countries this is more essential than in others. In some jurisdictions, direct funding support can be adequate to support the cost of a project in its entirety, though this is more often the case for television as opposed to feature film. In the U.K. for example, broadcasters typically pay the full cost of a production for primary rights; as a result, financing is only needed if the producer wants to exceed the budget in order to improve salability for secondary and tertiary rights.

In the area of Feature Film, countries like France have a high enough sustained level of output that there is a high number of private financiers willing to enter the market. In Quebec, Quebec Entertainment Investment Limited Partnership (FIDEC) – a limited partnership financing institution with Societe de developpement des entreprises culturelles (SODEC) as a key partner, offers a range of financing products to assist projects not able to achieve enough private backing and direct funding support. For Quebec producers, the interest rates from FIDEC can be lower than private banks. This encourages more producers to access FIDEC's financing products, including Gap and interim financing. Most importantly, FIDEC has developed the capability to estimate the value of foreign markets for productions, and thus is one of the few potential sources for Gap financing (not generally available through traditional bank financing).

3.3. Recommendation One: Build Stronger Cross-platform Companies

Overview

In order to encourage production companies to invest in cross-platform content and rights exploitation, a new set of financing instruments is recommended. Ontario should initiate programs specifically aimed at strengthening the balance sheets of cross-platform content creation companies. We believe these financial

instruments would provide support that would increase the availability of interim financing and decrease the costs associated with same.

To achieve these objectives, we recommend a program approach aimed at addressing the previously identified financing gaps and issues:

- An Early Stage Loan Guarantee Program;
- A Tax Credit Hold-back Loan Guarantee Program;
- An Interim Finance Costs Support Program; and
- A Gap Finance Costs Support Program.

We also recommend that over the longer term, the agency explore partnering with specialized financial institutions already providing these financing products, in order to facilitate the provision of more tailored and beneficial financial products to Ontario producers. This step could involve OMDC sharing in the investment of a pool of funds for this purpose, much like the backers of FIDEC have done. Alternatively, it could entail the OMDC becoming the first out-of-province partner with FIDEC itself. Such OMDC participation would help provide more tailored and beneficial financial products to Ontario producers. A number of possible arrangements should be explored along these lines with FIDEC or other appropriate financial institutions.

It is important to note that one of the options identified early in the study was the potential for the OMDC to set up a financing arm which would provide interim financing directly to producers. However, this approach is not recommended mainly because it would be very difficult for OMDC to replicate the skills of the private sector in credit and risk assessment, and to set up a specialized lending vehicle within the constraints of a government agency. Considering there are already other private institutions operating in this area, the suggested approach is to work with the private sector to address financing needs, and if need be, to partner with an existing institution. (e.g. FIDEC). For these reasons, this direct role is not recommended.

3.3.1. Loan Guarantee Programs

As explained above, screen-based projects are able to trigger their primary cash flow only after the “long form” contract is signed. However, significant development and production costs can be incurred before this is completed. This program would be designed to address these financing needs. Companies would be able to apply for private sector loans before the “long form” contract is finalized using OMDC loan guarantees. The Province could use a bonding agency to manage the additional loan risk incurred at this earlier stage.

A complementary program to offsetting fees would be to provide loan guarantees to producers for the tax credit “holdback” when interim financing is used to bridge producers to their tax credit receipts. Lenders typically will only lend 85-90% of the estimated value of the tax credits as a contingency against the tax credits being less than estimated. The result is that producers typically have to obtain other sources of financing to cover this 10-15% “holdback” of tax credit financing, usually through deferral of their production fees and overhead. Loan losses for the guaranteed portion of the tax credit loan are assumed to be negligible, since a loss requires both an overestimation of the tax credit amount and the inability of the producer to repay the overestimation.

Impact of the Program

The impact of implementing Loan Guarantee Program was estimated using a PricewaterhouseCoopers model created for this report (See Appendix A for details on the economic model). The proposed program enables producers to move into production prior to obtaining all the approvals for the release of their interim financing.

Benefits

A Loan Guarantee program would encourage the development of an early-stage lending industry where currently none exists, thus creating a method to ease producer cash flow issues.

Overall, an increase in access to early stage financing would enable Ontario producers to avoid production delays and eliminate the need to leverage all their corporate and/or personal working capital to finance the early stages of production for a project. Producers would then be able to concentrate on the critical elements of creating a production instead of on raising funds, and in the case of Television productions, would be able to better work with the peak-selling timetable of broadcasters.

Additionally, by enhancing early stage financing, producers will be better able to concentrate on the full breadth of cross-platform content creation, as opposed to settling for the main product due to financing restrictions.

We estimate that providing loan guarantees for early stage financing would provide the following benefits to the industry and to the Province (as derived from the PricewaterhouseCoopers economic model):

- Annual incremental increases in direct spending on cross-platform productions resulting from increased loan availability.
- Ability to focus on innovative platform content creation and improved overall quality in addition to main platform content.

- Avoidance of production delays due to lack of funding.
- Increase in quality of productions due to the higher spend, which may ultimately improve the marketability and revenue-generation potential of these projects.
- Reduction of the amount of producer fees that may need to be deferred.

Cost

Based on our economic model, to guarantee \$42.9 million in loans, the estimated annual cost to the Government of Ontario of potential loan losses and bonding fees is \$3 million. However, we estimate that the program would generate an estimated \$7.6 million annually in increased government revenue, due to the tax impact of additional production volumes. Therefore, according to the model, this program would therefore be cash-flow positive to the Treasury.

3.3.2. Interim Finance Costs Support Program

While the OMDC would be tasked with working with financial institutions over the long term to create methods of increasing access and competition within the financial industry providing interim financing for projects, the Government of Ontario can begin to support the needs of producers by instituting an Interim Finance Costs Program. As mentioned previously, the set-up fees paid to the financial intermediaries are substantial. By directly subsidizing these costs through a directed assistance program, Ontario could directly lessen the cost of financing for producers, thus allowing them to dedicate more funds into various aspects of their product strategy (main platform and cross-platform), or into their slate of future product offerings.

Impact of the Program

The impact of implementing an Interim Finance Costs Program was estimated using a PricewaterhouseCoopers model created for this report. (See Appendix A for details on the economic model.)

Benefits

Subsidizing the cost of legal fees and set up charges by banks would directly lower the cost of obtaining interim financing for producers. As a result, it may also substantially increase the demand for interim financing, particularly for small to mid-sized projects where set-up costs and legal fees would have been cost prohibitive in the past. Creating a more competitive market for interim financing for the sector could provide leverage in terms of costs, potentially creating a downward pressure on the interest rates currently charged for the financing.

The economic model estimates that instituting an Interim Finance Costs Program would provide substantial benefits for the industry and the Province. Estimated benefits to the industry, as derived from the PricewaterhouseCoopers economic model, would include:

- An annual incremental increase in direct spending on productions instead of indirect spending on loan set-up and legal fees;
- Increased ability to focus on innovative platform content creation and quality as opposed to main platform content;
- Avoidance of production delays due to lack of funding;
- Increases in quality of productions due to the higher spend and greater management focus which may ultimately improve the marketability and revenue-generation potential of these productions; and
- Reduction of the amount of producer fees that may need to be deferred.

Cost

Based on our economic model, the annual cost to the Government of Ontario, net of impacts on government revenues, is estimated to grow from \$3.9 million in Year 1 to \$4.4 million in Year 5.¹⁶ The total cost over five years is projected to be \$20.8 million.

3.3.3. Gap Financing Costs Support Program

Similar to Interim financing, we recommend a program to encourage greater accessibility to Gap Financing, including a program to offset fees and legal costs. By directly subsidizing these costs through a Gap Finance Costs Program, Ontario could lower the costs of such financing, making it attainable for more industry participants, thus allowing them to allocate more funds toward cross-platform production, quality, and development of foreign markets. With improved quality of product available for export, and improved access for producers to Gap Financing, it is anticipated that the demand for Gap Financing will increase, providing Gap financiers with increased opportunities in Ontario.

With a greater presence of Gap financiers in Ontario, producers would have increased access to Gap financing, possibly at better rates than are currently offered (and certainly at better terms than would be available from U.S. Gap financiers) due to the competitive nature of the industry. Already, since the appearance of a new financing institution in Ontario, there have been examples

¹⁶ This increase is due to an assumed 6% growth in loan volume, and thus a corresponding increase in interim financing requirements.

of producers who had been turned down for Gap financing by one financial institution being accepted by that same institution after the new institution made the producer an offer. Regardless, it is likely that producers would be able to open up new geographic markets that had previously been unavailable, and this outcome would lead to a boost in export sales for the producer.

Impact of the Program

The impact of instituting a Gap Financing Costs Program was estimated using a PricewaterhouseCoopers model created for this report. (See Appendix A for details on the economic model.)

Benefits

Overall, such an investment could result in major benefits to the industry. Film, TV and Digital Media producers would be able to create content that would increase content and breadth of copyright across multiple platforms, and retain the rights to their productions for more territories in the early stages of production. They would be able to take advantage of licensing those rights after the product is in production where the rights could potentially hold more value. Gap financing could provide an alternative to a pre-sale agreement or distribution advance that would automatically cap the returns from that territory or outlet, before the product is completed and a better understanding of salability can be determined. Moreover, the terms for Gap financing, while somewhat onerous, would likely be more favourable than deals put forward by foreign distributors.

The economic model shows that a Gap Finance Costs Program as recommended would potentially provide the following benefits to the industry and the Government of Ontario.

- An annual incremental increase in direct spending on productions instead of indirectly on loan set-up and legal fees.
- Increased ability to create multi-platform content instead of focusing solely on main platform content creation.
- Avoidance of production delays due to lack of funding.
- Increase in quality of productions due to the higher spend, which may ultimately improve the marketability and revenue-generation potential of these productions.
- Reduction of the amount of producer fees that may need to be deferred.

Though the figures shown above are modest compared to other measures, the impact could be more substantial. We anticipate there could be two main drivers for increased Gap financing.

First, the entire basket of recommendations is designed to produce more products that will create a synergistic effect, and can be of interest to audiences in foreign markets. The increase in this type of product would widen the demand for Gap financing for foreign territories, and possibly grow much more rapidly than is assumed in our model.

Second, Gap financing is a concept generally associated for geographic sales, but could be expanded to include new platform sales. When such sales become somewhat more predictable, financing might be extended to cover the “gap” between original production for a specific platform and that product being sold in that market. In this context, Gap financing could become very important to monetize the “long tail” payback for IP exploitation.

Cost

Based on our economic model, the annual cost to the Government of Ontario, net of impacts on government revenues, is estimated between \$0.3 million and \$0.4 million, due to an assumed 6% growth in loan volume. The total cost over five years is projected to be in the range of \$1.7 million.

3.4. *Resolve Tax Credit Cash Flow Issues*

While considered a part of financing for a project, the issue surrounding tax credits in Ontario is less a matter of financing itself as it is a matter of timing. Ontario currently has a strong tax credit offering for the sector. The Government of Ontario has recently announced the extension of the tax credit and the enhancement of the tax credit for small digital media businesses. As the situation is slightly different from the financing issues outlined above, we dealt with it separately.

Situation

The tax credit system in Ontario was originally intended to be used to reward production and to finance the next project. Due to competition between jurisdictions, tax credits have evolved into an effective means of securing the location of screen-based production.

The tax credit system in Ontario was never designed to be used for general financing for a company for more than one project, and they are an incomplete means of project financing in general. However, there is a serious concern around timing which impacts on a producer’s cash flow and financing; in that the current overall time lag of 12-18 months for receipt of tax credits results in an

increased cost of capital for producers who need financing in the interim. At present, the Ministry of Finance provides 85% of the tax credits six weeks after the production company files its annual tax return. While this is a significant improvement in timing, the payment still takes place well after the completion of the production relevant to the tax credits.

Currently, Quebec is the only jurisdiction in Canada that advances the value of the provincial tax credit to producers. In Quebec, SODEC provides loans to producers, which are based on the anticipated amount of the provincial tax credit.

Needs

Most important to the industry is the need to address the tax credit timing issue for producers in the Province. Addressing this issue could substantially reduce the cost of financing, and increase the amount of working capital available to producers. Currently, the time-lag for receipt of tax credits is lengthy and puts producers in the awkward position of having to apply for funding against their tax credits at a higher cost than were the tax credits advanced. This lag can cause production delays due to lack of funding and the time it takes to get financing to cover the equivalent of the tax credits.

There is a need for producers to better manage their working capital. This will help to improve cash flow and reduce the need for producers to have to defer their fees which restricts their ability to move onto the next project. As with the case of earlier and lower cost interim financing, earlier access to tax credits will directly help production companies to achieve a solid financial footing. At that stage, they will be more capable of making investments in the development of multi-platform projects.

By dealing with this issue, the Government of Ontario could substantially assist producers' cash flow for projects and increase the ability of producers to focus on production instead of having to go through another level of financing.

3.5. *Recommendation Two: Finance Screen-Based Industry Tax Credits*

To mitigate the negative cash flow effects for producers, we recommend the Government of Ontario address the tax credit issue as part of the overall Toolkit through one of the following actions, or through a combination of both:

- a) Advancing the tax credit as a one time expenditure; and/or
- b) Supporting the interest fees associated with production companies borrowing against the tax credit.

3.5.1. Advance the Tax Credits for all Eligible Productions

Focus

Through OMDC, the Government of Ontario should build on the current tax credits model by providing Ontario-based Film, Television and Digital Media companies and service companies with accelerated access to tax credits.

Scope

Advancing the tax credit would improve the working capital situation for Ontario producers. Rather than delaying the receipt of tax credits until after the filing of the return, OMDC could provide an advance equal to 85% of the tax credit (based on the production budget) upon the completion of the latter of:

- Completion of Stage 2 by the OMDC/Agency (eligibility review and tax credit estimate); or
- Commencement of principal photography.

Benefits

By advancing the tax credit, production companies will be better equipped to match the production company's cash inflows and outflows, and thus reduce the interest costs of producers who would otherwise need to obtain bank financing, and the amount of producer fees that would need to be deferred. The increase in working capital from the credits would also allow producers to concentrate on quality content creation for both the main platform and cross-platform initiatives, thus increasing the value of the product and the breadth of content under Ontario copyright.

We estimate that advancing the provincial tax credits would provide benefits both to the industry and to the Province. Estimated benefits to the industry, based on immediate advance of all eligible tax credits, include:

- Annual incremental increases in direct spending on productions, instead of indirectly on loan interest;
- Avoidance of production delays due to lack of funding;
- An increase in the quality of productions due to higher spend at the right time, which should ultimately improve the marketability and revenue-generation potential of these productions;
- Reduction of the amount of producer fees that may need to be deferred;

- Increase in working capital; and
- Increase of focus on production (instead of financing).

Challenges

There may be challenges associated with implementing the advancement of the tax credits, led by the significant one time cost to advance the early tax credit payout. Banks currently involved in interim financing would need to reassess as this approach would have impacts on this lending market.

It is important to note that tax credits and adjustments are mainly built into the financial structure of the production of a film, TV show, or digital media product. Although they were once perceived at the Federal level as a stimulus for building a sustainable industry, tax credit financing has become essential for the financial structure of a content product.

Cost

Based on our economic model, the annual cost to the Government of Ontario, net of impacts on government revenues, is estimated to be \$135.9 million in Year 1 due to the one-time cost of bringing the tax credits forward 18 months. Ongoing benefits to the treasury are \$2.2 – \$2.8 million per year, due to related increases in production spending. In subsequent years, there will be no incremental impact on Government spend, but the benefits to the industry will continue as long as the tax credit acceleration is in place. The total cost over five years is estimated to be \$135.9 million.

3.5.2. Fund Interest Costs Associated with the Tax Credits

In lieu of advancing the tax credits, the Government of Ontario could fund the interest costs associated with loans to bridge producers to the point of receiving the tax credit.

In this case, production companies would be better equipped to match cash inflows and outflows. The increase in working capital from the funding of interest would also allow producers to concentrate on quality content creation for both the main platform and cross-platform initiatives, thus increasing the value of the product and the breadth of content under Ontario copyright.

We estimate that funding the interest costs would provide benefits both to the industry and to the Province. Estimated benefits to the industry include:

- Annual incremental increases in direct spending on productions, instead of indirectly on loan interest;

- Avoidance of production delays due to lack of funding;
- An increase in the quality of productions due to higher spend, which may ultimately improve the marketability and revenue-generation potential of these productions;
- Reduction of the amount of producer fees that may need to be deferred;
- Increase in working capital; and
- Increase of focus on production (instead of financing).

Cost

The annual cost to the Government of Ontario, net of impacts on government revenues, is estimated to be \$10.2 – \$12.9 million per year.

4. Screen-based Project Quality and Recognition

4.1. *Development*

Situation

Currently, approximately one-third of OMDC's feature Film Fund goes towards development projects. That is, the funds provide support for project pre-production: to improve the script, to fine-tune the concept, or to review the creative production plan. This relatively high proportion allocated to development funding may appear disproportionate. However, the fund is not large so there is more leverage at the development stage than in production financing. Annual funding for FY 2005/06 was approximately \$340,000 for development for feature film. Funding is currently allocated on a project-by-project basis, as opposed to long-term corporate slate development.

Needs

The time and effort expended on a project at the outset can have a significant impact on the quality and commercial viability of the end-product. While there are a number of development money sources in Canada, there is a shortage in two areas: first, there is insufficient funding of early stage concept development¹⁷; second, another critical shortage can occur when projects are nearly ready for production, but still need to rework the script, strengthen the cast, etc.

Sometimes a producer has to push the project into production before it is ready in order to generate cash. More time should be devoted to fully prepare the ground creatively, and from a business perspective, before principal photography begins. In many cases, then, development is a stage when additional funding would be strongly beneficial in terms of the end quality of the overall production.¹⁸

Additionally, the development stage is critical for determining the most appropriate platforms for content delivery, including determining potential options, sequencing of cross-platform initiatives, and designing production schedules and creative content most conducive to the differing streams of content delivery. As a result, there is a need for the selection criteria for recipients of development funding to include a determination of potential multi-platform initiatives.

¹⁷ Wayne Clarkson, Executive Director of Telefilm, pointed out in remarks to the Standing Committee on Canadian Heritage in 2005 that to improve the quality of Canadian films, the Canadian industry needs to have a higher number of projects that move into the development stage, relative to the number of projects that eventually go on to be produced. Canada develops only 4 productions for every one produced – this is compared to a ratio of eight to one in Europe and 9 to one in Hollywood.

¹⁸ This critical juncture is recognized in the pre-production stage financing that certain feature film projects obtain from the federal Feature Film Fund. See the Summative Evaluation of the Feature Film Policy, op. cit.

Overall, product development is an important aspect of any economically sustainable industry. A growing industry requires adequate development efforts to fuel that growth. However, based on experience in other jurisdictions, the industry needs to shift the emphasis from individual project development to multi-project slate development in order to encourage a top-tier of companies with increased output and commercial success.

4.2. Production

Situation

In 2005/6 \$1.16 million was provided to seven production-ready feature film projects. The funding was in the form of a repayable advance and was “last-in” financing. The maximum available per project was \$250,000 in 2005/06, increasing to \$300,000 in 2006/07.

While valuable as a contribution to offset the possible advantages of equity financing from other provinces, these amounts were clearly secondary in the project financing of multi-million dollar budget feature films.

Digital media production in Ontario currently strikes a balance between fee-for-service work and exploitation of intellectual property. Approximately 50% of the revenue of the typical Ontario digital media content creator comes from the development of intellectual property. An additional 50% comes from fee-for-service activities.

Needs

In order to reach increased levels of output in the Province and ensure that output is economically sustainable in the long term, there needs to be a targeted increase in the amount of direct support for production, to ensure that, for example, higher-budget, multi-platform, and commercially viable projects are encouraged. Additionally, the total number of projects funded needs to increase so as to increase output levels. A key part of production funding would need to be specifically directed toward:

- Enhanced cross-platform content creation;
- Companies producing multiple projects; and
- Projects meeting criteria for revenue generation.

Experience in Other Jurisdictions

Film and Television

Most countries in the world with a recognizable Feature Film industry support it through direct funding. For example, in Europe the average support per country through both direct funding of feature film and through tax credits is approximately \$4 to \$5 per capita¹⁹.

In Quebec, where the theatrical box office market share of provincial feature has reached up to 25% in recent years,²⁰ direct feature film and television support from the Province totaled \$26.4 million in 2005-06. Of this amount, about \$19.5 million is set aside for production, \$2.4 million for development, and \$2.9 million in support of distribution, marketing and export-promotion initiatives. On top of this Provincial funding, Quebec-based producers can access production-support funds in the Federal Government's Canada Feature Film Fund. The Canada Feature Film Fund provided some \$20 million in production funding to Quebec-based producers.

In other jurisdictions, direct support funds for Film and Television are typically divided into three areas: development, production and marketing/distribution. In Europe, the average proportional split in these three areas is: 5% for development; 85% for production; and 10% for distribution and promotion²¹. In Quebec, there is a greater proportion spent on development and marketing and distribution. Of the \$26.4 million in available funding, \$2.4 million, or 9% went to development; and \$2.9 million, or 11% went to distribution and marketing initiatives.

However, Quebec also spends a significant amount on production funding per project. Currently, the maximum amount SODEC puts into a film is \$2 million, as compared to Ontario, where the maximum amount is \$300,000 for 2006/07. Additionally, in many jurisdictions, including Quebec, a great deal of the development funding is apportioned towards 'slate development' in addition to project development. In this case, attractive proposals from applicants with proven track records are granted funding for a period of several years to develop a range of projects with the recognition that not all will be seen to fruition. An academic study examining the impact of subsidies in Germany, found that the

19 Averages from Copenhagen Think Tank on European Film and Film Policy, Information Notes – Number 1: Public Funding of Production in Europe, June 20, 2006, available at < http://www.dfi.dk/NR/rdonlyres/1BE19F2D-F61F-403F-934C-B0AB2447D9D8/0/CTT_Information_Notes_300606.pdf>.

20 Department of Canadian Heritage, Summative Evaluation of the Feature Film Policy, September 2005, p. 22, available at <http://www.pch.gc.ca/progs/em-cr/eval2005_e.cfm>.

21 Copenhagen Think Tank on European Film and Film Policy, Information Notes – Number 1: Public Funding of Production in Europe, June 20, 2006, p. 18 available at < http://www.dfi.dk/NR/rdonlyres/1BE19F2D-F61F-403F-934C-B0AB2447D9D8/0/CTT_Information_Notes_300606.pdf>.

effect of assistance granted to very successful production companies was a key determinant for a film's success²².

In Quebec and most other jurisdictions, the majority of support funds are recoupable, as is the current fund in Ontario. At times, a limited percentage is set aside for non-recoupable investment.

Internationally, funds are allocated to Film and Television projects either by selective or automatic criteria. Selective funding is often determined by the agency in response to criteria based on combined cultural and economic goals. Some agencies (e.g., OMDC, New Zealand Film) ensure that industry representatives form selection committees to distribute funds, whereas in other jurisdictions, including a number of regions in Germany, committees composed entirely of government officials make selections.

Alternatively, performance-based (also known as automatic) decisions would entail a production company receiving funding for a project if a previous production has fared well commercially. While most European countries favour selective funding, there is debate about which type of funding leads to greater commercial and creative success. An academic study examining success of films in Germany demonstrates that there was a greater commercial success correlation between films judged on a performance basis as compared to a selective basis as the performance process was market driven.²³

In many jurisdictions, marketing and distribution forms a critical component of direct support funds for Feature Film and Television. In Quebec, the marketing fund is aimed at distributors who distribute Quebecois films but also international films. France and the U.K., in addition to other countries, manage similar programs. In a number of these countries, there are also funds dedicated toward encouraging the viewing of specialist films, either by supporting independent theatres, special initiatives to encourage audiences for specialized films, or supporting digital screen conversion which enables greater flexibility of film choices in theatres.

Digital Media and 360 Degree Project Support

In a number of jurisdictions, support for the production and development of digital media is increasing in importance. Approximately ten years ago, Scotland established strong public support programs to foster a strong television sector in the nation, and has since succeeded. It is now turning its attention to creating a highly innovative interactive sector that can work with the TV industry to create a

22 Christian Jansen, "The Performance of German Motion Pictures, Profits and Subsidies: Some Empirical Evidence, Journal of Cultural Economics, 2005, vol. 25, no. 3, p. 201.

23 Christian Jansen, "The Performance of German Motion Pictures, Profits and Subsidies: Some Empirical Evidence, Journal of Cultural Economics, 2005, vol. 25, no. 3, p. 201.

strong creative cluster. Initiatives include the Scottish Digital Media and Creative Industries Project Fund – with this fund, private sector partners apply to Scottish Enterprise to become co-investors in a project, spanning film and television, but also interactive games and publishing.²⁴

In France, the influential and well-funded film agency, Centre Nationale de la Cinematographie (CNC), has in recent years established a program called FAEM (translated as a support fund for multimedia publishing). This fund offers recoupable funds for the development and production of multimedia projects.

There are also a number of funds that support cross-platform interactive projects, projects which combine digital media and TV content and are also known as “360 degree” projects. As the establishment of business models and standard terms of trade is in early stages in many jurisdictions, such funding support – whether private or public – is critical to encourage production of these types of projects.

At a national level in Canada, the Bell Broadcast and New Media Fund has been instrumental in encouraging the production of innovative 360-degree projects. For example, the fall launch of *This is Emily Yeung* – the follow-on to the hugely successful children’s TV series *This is Daniel Cook* – received funding from the Bell Fund which has enabled the producers to trial a number of innovative applications on an associated website, a project which may not have happened without this additional funding.²⁵

The OMDC Interactive Digital Media Fund supports Ontario-based, Canadian-owned interactive digital media producers to develop projects on a variety of platforms. In 2005-6 OMDC’s \$550,000 supported seven projects with a total budget value of about \$2.7 million.

4.3. Marketing and Distribution

Situation

Currently, Ontario screen-based content producers struggle to achieve significant commercial success both abroad and domestically. With respect to feature films Ontario’s film audiences are “hooked on Hollywood” product, and the major studios thereby have substantial leverage over the exhibition sector. Some independent theatres provide more opportunities for Canadian films – since they cannot compete with the major chains for opening studio product. However, few

24 Scottish Enterprise, Scottish Digital Media and Creative Industries Project Fund: Essential Facts; available at http://www.scottish-enterprise.com/publications/dm_ciproject_fund_factsheet.pdf.

25 Corus Entertainment, “Corus Entertainment Multiplatform Projects Bolstered by Bell Fund,” press release, April 7, 2006, available at http://www.tribalnova.com/presse/Content_Bell%20Fund%20Recipients_FINAL%20April%2010.pdf#search=%22Emily%20Yeung%20Bell%20Fund%22.

independent theatres exist in Ontario, and even in Toronto there has been a spate of closures of independent theatres.

Because of the size of the Canadian market and the lack of distribution outlets domestically, international success is critical for Ontario screen-based industry products in order to expand the market for Ontario product. In order to achieve this international success, it is essential that a diverse range of high quality Ontario product be created. However, there is also a need to encourage foreign distributors and sales agents to market and distribute such product. There are virtually no international sales agents operating in Canada, or agents that focus specifically on Ontario product offerings. The buy-in and support of international sales agents is essential for producers to be able to sell their projects abroad.

Ontario digital media content creators are also dependent on foreign sales and marketing. Over 50% of companies have foreign sales, representing about 60% of total sales. About 50% of these companies use sales agents for export sales.

Additionally, only a small number of content creation companies have the internal capability to focus directly on international sales, whereas many companies are interested in finding ways to sell internationally. Companies generally do not have the marketing budgets to develop international exposure.

Currently, OMDC runs a number of initiatives to support sales and marketing, including operating a sales booth at the Toronto International Film Festival and the recently launched International Film Finance Forum. The agency also offers an export marketing program which, in 2005-6, supported 89 Ontario cultural entrepreneurs to attend 10 international markets. OMDC provided support for Ontario companies attending international markets through the Canada Stand.

OMDC, the City of Toronto and FilmOntario partner to staff a two-person Los Angeles office. In 2005-6, this office assisted in attracting 19 projects with an estimated economic impact of \$140 million.

In terms of market information and market intelligence, there is substantial information regarding markets available through private organizations, and to some extent available from Telefilm. However, there is no coordinating body to collect and disseminate information about potential markets and sales opportunities abroad. As well, there is no coordinated effort to create a strategic plan or on-going initiatives to take advantage of foreign market opportunities. This lack of coordination also extends to market intelligence regarding market opportunities within Canada that could be leveraged to bring more projects to Ontario (i.e., through monitoring of regulatory decisions affecting Canadian content, funding decision by Telefilm, etc.).

Needs

There needs to be a concerted marketing effort to aggressively market and promote Ontario products internationally and to market, promote, and advocate for Ontario as a key location for production. Together, these would build infrastructure and a sustainable industry.

Producers need support from those who can promote and represent their diverse range of content in any and all screen-based platforms in the global marketplace, and take the lead role in fostering relationships with key buyers/distributors to position Ontario early in the minds of producers. These individuals would be tasked with promoting and showcasing Ontario's sector offerings to the international marketplace through a proactive person-to-person, relationship based approach, rather than through only trade show representation. They would also need to have the awareness to market product using the same "360-degree" approach as is needed for development and production, to ensure that all Ontario content is being represented and sold for the appropriate price.

Additionally, more support is needed for the intermediaries that carry Ontario product. Sales agents and distributors can be more effective than producers in securing international Film and TV sales as they have the expertise and the contacts. If there are also associated multi-platform offerings, they can be promoted at the same time given the increasing awareness of the full range of opportunities created by multimedia productions. As a result, agent and distributor buy-in is essential, including their belief in the quality of the product, the actors, the director, and other positive factors that could enhance the product's marketability abroad. Therefore, there is a need to encourage sales agents/distributors to aggressively market Ontario product through commissions, incentives, and a wide library from which to sell products.

There is also an opportunity to create a vehicle that would disseminate technical knowledge and market intelligence to the production community in Ontario, one that can commission and outsource specific market intelligence studies as needed. The clearinghouse could also enable the building of links between traditional producers and digital media companies at both the creative and technology levels, in both directions. This intelligence would be oriented both internationally and domestically, so Ontario could leverage what is going on in other jurisdictions and provinces and capitalize on potential opportunities and industry breakthroughs.

Overall, product marketing and distribution is an instrumental aspect of any economically sustainable industry. As a result, Marketing support should include a program to cover costs associated with project-specific marketing and distribution efforts (e.g. developing trailers and promotional materials) and a program aimed at creating an industry brand for the province and on developing a pro-active marketing intelligence approach.

Experience in Other Jurisdictions

Most European countries and many other countries internationally, place great emphasis within their associated creative industries' policy on providing high-level market intelligence about foreign markets in addition to providing marketing support for local product.

Those that are successful at selling abroad attract a strong presence of international sales agents and distributors in the country. Unfortunately, there is a circular relationship: countries can succeed internationally if they have a strong presence of such intermediaries, however, rarely are intermediaries interested in setting up shop unless the country is successful overseas. In France and the U.K. for example, there is both a critical mass of international sales agents focused on selling domestic film abroad, and also a critical mass of production in those countries in which foreign buyers are interested.

Also, some countries have programs and institutions which seek to encourage the activities of sales agents abroad. For example, in France, the CNC has an arm called *UniFrance*²⁶ which brings together close to 500 members, including feature film and short film producers, sales agents, directors and actors to promote French feature films abroad. It not only seeks to promote French films abroad, but also tracks performance of French films abroad, and works closely with sales agents and producers as they prepare to canvass films at foreign markets.

New Zealand Film (the public sector Film agency) has gone one step further to encourage the sales of its feature films abroad, in that it acts as the sales agent for the films it funds. New Zealand began doing this after realizing that its Film industry was not large enough to facilitate the existence of international sales agents operating in the country, while also recognizing that sales agents acting on the country's behalf were essential.

²⁶ For more information, see <http://www.unifrance.org/>

5. Recommendation Three: Improve Cross-platform Content Quality and Volumes

In addition to building stronger company balance sheets, funding is needed to improve cross-platform content quality and increase volumes of screen-based content production.

5.1. Content Creation Fund

OMDC should increase the number of screen-based projects directly funded to build up the level of supply coming from the Province. This funding should primarily be in the form of performance based funds to encourage a commercially driven industry, with quality outputs that are leveraging content across a breadth of platforms (i.e., TV show with online mobisodes). In order to migrate to a performance based assessment framework, we recommend that projects be evaluated based on a series of attributes to be determined during the set up of the program. The development of the assessment framework should include a consultation process involving industry participants.

To a large degree, the Content Creation Fund would build from the existing OMDC Film Fund, with an enhanced multi-platform mandate and funding. This funding would be made available to targeted projects for development, production, and/or marketing and distribution to encourage exploitation of Ontario-based intellectual property.

It is also important to note that for the following programs, deadlines should be flexible as opposed to annual or bi-annual to allow for projects to move forward according to their own timelines. Such flexibility would limit production delays and allow for producers to fit their applications to the unique environments in which they operate.

5.1.1. Development

The Government of Ontario should increase the overall amount of direct support funding for development. This approach would help to instill a broader sense of development in producers of content at the onset of a project. By increasing the amount of funds allotted for development to be in line with the increase in the overall financing framework, OMDC will be able to maintain a ratio of development to production funding which is higher than most European countries, and in-line with Quebec.

Based on experience in other jurisdictions, the Government of Ontario should shift the emphasis from individual project development to multi-project slate development in order to encourage a top-tier of companies with increased output

and commercial success. Such multi-project slate development should be apportioned over a period of several years, similar to SODEC, in order to bring a range of projects to the table for possible production.

The selection of companies for slate funding should primarily be determined through the application of performance-based criteria that is based on previous indications of success and the company's level of activity. A percentage of support funding should also be reserved for selective funding to encourage independent films and to ensure that mid-level companies or up-and-coming talent are given an opportunity to develop. It is important to support emergent content creators even while leveraging the talents of those with a track record in order to ensure longevity of the industry and a constant inflow of creative and diverse talent.

It is important for increased product quality to be injected into projects during the development phase in order to increase the value of the intellectual property from the beginning of the creative process. Funding of development activities (e.g. script revisions, focus-group testing) should be based on criteria that include the project's commercial prospects.

Additionally, one of the criteria for funding should be evidence of 360-degree thinking from the inception of the project, with an examination of potential platforms for production and delivery. Additionally, any plan to incorporate non-traditional media components into the development stage, including potential audience testing of new-media components, development of ancillary content for digital media tie-ins (i.e., mobisodes, linked content websites), should be considered as a mandatory requirement in any funding application (i.e., contract with a digital media company, hiring of specialized staff, etc.).

In order to create a sustainable industry at the heart of the E&CC, there is a need to think of the final product as a "cluster of products" as opposed to the traditional "Film, Television, or Digital Media." This approach will require a need to orient production companies toward this multi-platform thinking from the development stage, with the recognition that there is a continuous need for learning and information sharing in this rapidly developing field.

With more funding for development, Ontario producers will have more time and resources to improve the quality and commercial viability of Ontario screen-based products before going into production. Producers will be able to take even more creative approaches to product development while also managing the business issues before principal photography and other significant production efforts commence.

5.1.2. Production

A larger production fund, as part of the funding to improve content quality and grow production volumes, would encourage a greater number of multi-platform projects to reach completion. The increased fund would enable Ontario producers to retain more territory rights until the product is made. Rights retention coupled with increased content could then be leveraged for the longer term benefit of production companies.

It is proposed that funding used to improve content quality and to grow volumes be directed primarily towards private companies' screen-based productions of potentially commercially viable projects. A performance based criteria should also be applied to direct this type of development funding. Encouraging additional production of quality projects that may generate above-average revenues will move the industry toward economic success and sustainability as higher quality content will lead to enhanced market opportunities, especially for foreign markets.

It is also proposed that several projects per year be set aside for selection based on other criteria, similar to the SODEC model.²⁷ Selective components of the funding model would be designed to give priority to new participants in the industry that do not have a track record in the industry. This would enhance the potential of these companies to produce and distribute innovative projects. Over the longer term, this support is critical for fostering a strong industry.

5.1.3. Marketing and Distribution

Marketing and distribution support is critical for projects to reach their full commercial potential. We recommend a project-specific integrated marketing and distribution component as part of the overall content creation fund.

Support for project-specific marketing and distribution should be directed towards three areas:

- Marketing for distribution companies;
- Support for project specific export development initiatives; and

²⁷ Ontario must ensure that it retains a selective component to performance based funding – over time, there may be too many companies qualifying for too little funding, necessitating the agency reserving the right to final selection. This has happened with the Telefilm performance based component within Quebec. The performance based component has not been large enough to support everyone that qualifies – therefore, the two have to be combined in some way by evaluating against attributes of a project. For example, a combination of prior box office success and future potential to ensure the appropriate range and diversity of film. Such evaluation has been happening with Telefilm.

- Special events – festivals, markets, and film appreciation events in support of specific projects.

Marketing support should be allocated to distributors who are distributing Ontario products. Support should include costs associated with distribution of the project (i.e., innovative promotional material, shorts, DVD publishing, launch costs and the production of trailers and web-based or similar digital marketing materials, etc.). Distribution funding could also be geared toward distribution companies looking to expand their channels for Ontario products.

OMDC currently provides support to producers to help them pursue export development by sending them to festivals and international events. Such initiatives are positive as they create exposure for Canadian producers, give access to environments conducive to presales, and allow for marketing of individual projects. In the future, we recommend that this type of funding form only a small component of the distribution and marketing oriented investments as it is not the only method of marketing Ontario product. After the project creation phase has been completed, marketing of Ontario product is best managed by distributors, promoters, and sales agents. Direct support should be provided to these parties to support their involvement of marketing Ontario product. (Please see Recommendation Five: Brand and Market the Screen-Based Industry below for details on marketing recommendations that are not project specific).

Ontario should also work collaboratively with independent theatres and theatrical chains to encourage attendance, marketing, and support for Ontario-produced films. Ongoing activities such as the Toronto International Film Festival, the Film Circuit, and other industry events (i.e., trade shows) will also continue to be critical for the exhibition of Ontario films. OMDC should continue to work closely with such initiatives to find methods to encourage the viewing of Ontario-produced films.

A heightened level of support for the marketing and distribution of Ontario screen-based projects could help to increase audiences for such projects. The increased support for producers, distributors, and theatres would enhance the economic and commercial viability of the sector as a whole.

Impact of the Program

The impact of instituting a Content Creation Fund was estimated using a PricewaterhouseCoopers model created for this report. (See Appendix A for details on the economic model.)

Benefits

Estimated benefits to the industry, as derived from the PricewaterhouseCoopers economic model include:

- Improved content quality and development of cross-platform content; and
- Increased revenue returned for production dollar spent, based on:
 - Production of higher quality projects with improved prospects for domestic and foreign revenue;
 - Improved exploitation of intellectual property value across multiple screen platforms; and
 - Enhanced support for marketing and distribution.

Cost

Based on the economic model, the cost to the Ontario Government, net of direct payback in the form of Government revenues is estimated to be in the range of \$12.0 – 12.9 million per year.

6. Sector Strength and Excellence

6.1. Advocacy

Situation

At present, the industry believes that there is no real face to the screen-based industries in Ontario, one with the focus needed to advocate on behalf of their interests at the Provincial and Federal levels. While the Digital Media, Film, and TV production community have their individual and common stakeholder advocacy organizations, there is no “public” face. The Ministry of Culture is a Government department with a mandate that spans the gamut of the cultural sector. OMDC is an operational agency that administers the tax credit process and manages other support measures for the industry.

Needs

There is a need for an enhanced Government agency where the industry voice is strong enough to ensure the full confidence of the sector, and represent it appropriately. For example, it should have the capability to ensure that any new funding that is provided to the sector does not simply trigger a reduction in the funding by another agency. This agency would need a mandate to advocate on behalf of the industry at the Provincial; Federal; and global levels.

More specifically, the mandate of the agency would need to include:

- Becoming a single, coordinating force which can bring together Government of Ontario ministries to achieve a seamless support mechanism for the E&CC;
- Providing a strong voice for the province’s TV, Film, and Digital Media sector at the Federal Government level by:
 - Putting forward policies that would enhance Ontario’s position;
 - Advocating on behalf of Ontario in order to sustain its role as a centre of excellence in Canada for screen-based industries;
 - Working toward ensuring equitable support from the Federal Government and its agencies (e.g. Telefilm, Canadian Heritage, Export Development Canada, Human Resources Development Canada (HRDC), etc.); and
 - Acting on behalf of Ontario’s industry during regulatory proceedings of the CRTC, and representing the industry before other public

bodies (e.g. Parliamentary Committee on Culture and its review of feature film policy which it conducted in 2005).

- Providing and supporting targeted international representation of the industry in concurrence with the Ministry of Economic Development and Trade.

6.2. Recommendation Four: Advocacy Program

We recommend a direct Advocacy program to be based within a revitalized OMDC. The enhanced OMDC should have the strength, mandate, and support needed to advocate on behalf of Ontario's screen-based industry, a role which would include:

- Becoming the driving force to bring together Ontario ministries to achieve a seamless support mechanism for the industry that would give it the ability to take measures needed to increase the sustainability of the sector and enhance the economic impact on the Province as a whole;
- Taking a proactive role as the face of the Province's screen-based industry sector at the Federal Government level. This role would include acting on behalf of Ontario's industry by advocating for policies that would promote Ontario's position as a Centre of Excellence in Canada for the sector, and for programs aligned to the new Ontario model; and
- Advocating for recognition of the importance of Ontario's E&CC in terms of various Federal support instruments and other federal policy, tax, and legislative changes for the benefit of Ontario-based industry.

In order to act as an effective advocate, OMDC will need to involve the Industry Advisory Committee and other relevant stakeholders at all levels of the management and advocacy process – to ensure industry concerns are being addressed while still meeting the priorities of the Government of Ontario.

Advocacy would not only involve the face to face advocacy inherent in presenting a position; in addition to direct advocacy functions, this program would also include support for advocacy endeavours, including advocacy campaigns, obtaining legal opinions, and conducting studies to support the industry position on a specific matter.

6.3. Sector-specific Marketing

Sector specific marketing needs arise from the same challenges and opportunities as outlined in the Marketing and Distribution section above.

It is imperative to note that project specific marketing is essential. Brand recognition and “staying power” of sector-specific marketing initiatives (e.g. branding Ontario screen-based content) will also be essential to improve overall product recognition and ensure longevity and long-term sustainability.

6.4. Recommendation Five: Brand and Market the Screen-based Industry

OMDC’s screen-based industry unit would have specialized marketing and promotions capability to design and execute specific marketing initiatives to promote the sector. As a first step toward this objective, OMDC should partner with the industry cluster to develop a compelling brand for the province aimed at leveraging markets for Ontario products, and promoting Ontario as a production centre for export productions. Creating a brand would add consistency and leverage to overall industry marketing endeavours.

OMDC should be responsible for raising the profile of Ontario on the world stage as a vibrant and progressive jurisdiction, through the branding initiatives and through targeted international representation in concurrence with the Ministry of Economic Development and Trade. This representation would be aimed both at promoting domestic production and showcasing Ontario’s service production environment.

In terms of international sales, OMDC would need to foster an internationally focused production culture which can attract interest from foreign buyers and in turn encourage sales agents to set up business in Ontario, or to actively seek out Ontario products. OMDC could do this by actively encouraging international sales agents to represent Ontario product through commissions and incentives, and/or by funding special promoters to represent the library of Ontario product by proactively building relationships with sales agents and facilitating relationships between agents and producers.

As a part of this approach, OMDC should develop and build on current activities such as a sales office at the Film Festival and the International Film Finance Forum to market the benefit of Ontario films to international sales agents. OMDC should focus less on “events” and more on developing one-to-one relationships with key international sales agents, distributors, and other buyers.

In concurrence with this promotional activity, OMDC should also encourage an international focus in company strategic development by lending advice and support on distribution, finding sales agents, tailoring content to international markets, and hosting industry workshops on new opportunities and sales methods.

The marketing unit should have a key intelligence function which would outsource market studies and collect market information on key Canadian and international markets, and on the growing cross-platform trends impacting marketing and distribution. A primary focus should be on the proactive dissemination of such knowledge to the rest of the sector through a collaborative networking-based approach. (e.g., through hosting and sponsoring targeted industry events aimed at increasing awareness of sector issues, such as bed-testing).

6.5. Research and Innovation

Situation

There appears to be a “silo mentality” regarding research and innovation within screen-based industry sector, with little connection between complementary media (i.e. Feature Film and Digital Media, especially, but also between interactive and television). While advances are being made within the sector, there have been few attempts to create a means to disseminate the findings of such research, or to bring industry participants together to develop trials, conduct research, and foster knowledge creation.

Another issue arises because digital media companies are growing very rapidly and in many cases have more opportunities within their existing “comfort zone” than they can work with – although financing remains a major issue. This relatively greater cross-platform savvy competes against the more mature parts of the screen-based sector, which could mean they would receive less support.

Needs

The need to support research and innovation in new streams of complementary product is critical for building a sustainable sector for the Province. Both the traditional and emerging media need flexibility, knowledge, and appropriate skill-sets to excel in the cross-platform arena that will underpin the E&CC in the future.

To respond to these gaps, there is a fundamental need for a broad-based approach to funding research and innovation to allow industry participants to be on the cutting edge of technology. There needs to be a pro-active approach toward collecting industry information, and government investment and interest in

supporting digital media opportunities, trials, and tests (i.e., bed-testing of innovative platforms for product delivery, new modes of content creation, ancillary content creation, and multi-platform marketing initiatives) to allow the sector to explore and take advantage of new technologies and distribution mechanisms.

Most importantly, there needs to be a fundamental shift with regard to financing and support mechanisms for the screen-based industry, to a point where it fully incorporates the importance of multi-platform thinking. Critical is a need to enshrine in the criteria of any financing and support mechanisms a focus on innovative thinking, multi-platform consideration, partnerships between production companies and new-media companies. Evaluating against these criteria would enable the screen-based industry to leverage the knowledge and skills available in the Province and enhance the overall output, quality, and range of products being created.

Experience in Other Jurisdictions

Certain cultural agencies around the world actively engage in research and innovation activities for their industries. Such agencies work with industry, industry associations, and often academia to facilitate innovation in the sector.

In the U.K. for example, several screen and regional development agencies including the regional development agency in Yorkshire and the creative industries agency, *Creative London*, have teamed with the British Broadcasting Corporation (BBC) and the industry association, Producers Alliance for Cinema and Television (PACT) to develop 'Innovation Labs'. Together they facilitate the creation of new interactive applications to be trialed within the BBC. Participants can pitch the projects to BBC commissioners and, if accepted, receive a license fee while retaining the IP rights. The initiative is new, but it provides an interesting example of a partnership with a buyer which results in the retention of IP.

6.6. Recommendation Six: Encourage Research and Innovation

In an era where new platforms and modes of content delivery are constantly changing, OMDC should create a program which would give production companies and digital media companies the ability to investigate and pursue a 360 degree approach toward product design. Such a program is critical if Ontario producers are to compete in the global marketplace.

In line with the Government of Ontario's interest in Research and Innovation, the "retooled" OMDC would encourage and fund cross-platform experimentation, and act as an intermediary among industry participants. It would also create a forum

for discussion regarding cross-platform and digital media opportunities, including fostering relationships with key industry professionals who can lead discussions, or provide insight/experiences for others.

Most importantly, the Agency would sponsor the development of specific research and innovation initiatives aimed at trialing potential platforms, concepts, and approaches that could bring benefit to the Ontario screen-based industry sector.

The focus of the majority of research and innovation funding should be on the development and testing of concepts that will harness interactive and digital media opportunities which could create additional content and copyright for Ontario production companies. Such research could be conducted by cross-platform companies, partnerships with educational institutions, partnerships with other development and innovation funds, and/or through independent research programs.

Cost

The cost of these three sector-wide programs is estimated to be \$5 million annually in incremental funding to the OMDC, which would take a lead role in managing each program.

7. Operationalization of Policy

Situation

Industry participants currently believe they have been granted less input into policy development and direction than is needed for the sector to achieve the results that are possible. While stakeholder consultations do occur on an “issue by issue” basis, there is no mechanism to ensure what the industry considers meaningful change will result from such consultations. Stakeholders perceive that concerns they have raised are not effectively being addressed.

There is a perception, within the industry, that there is a lack of direct industry representation among those making decisions. It is not addressed by representation on the OMDC Board of Directors, given the wide range of stakeholders represented there. Discussions within this forum can result in the interests of the screen-based sector being diffused.

Needs

It is essential for the industry and the Government of Ontario to work hand in hand. The Government has the responsibility for policy, but should obtain more intensive advice for policy development and program implementation from industry representatives. While it is unlikely the Government of Ontario will give authority over broad policy direction to an agency like the OMDC, there should be mechanisms in place to ensure that the Agency’s industry expertise comes to bear in new policy development.

There is a need for more opportunities for input from the industry on policy development and direction, and a structured process to obtain the input from industry stakeholders.

There is also a need for the funding and resources to create and implement programs to operationalize the Government’s policy decisions concerning the sector without the need for day-to-day Government approval.

Experience in Other Jurisdictions

In Quebec, SODEC is the champion for the creative industries. For Feature Film and Television in particular, SODEC is involved in events and policy related to the industries within its remit. It works with industry and Government, at both a national and a Federal level to advocate for the creative industries (except for digital media, which is not within its current domain).

In addition, at its highest level, SODEC works with the Government of Quebec to develop policy direction for the Province’s creative industries. While the agency

does not set policy *per se*, it is seen as a trusted adviser by the Provincial Government and is often a partner in policy creation.

Similar to Quebec, France's national agency CNC is responsible for working closely with the national government to advise on and set national policy.

With respect to pan-European Union (EU) activities, the Copenhagen think tank is a European initiative facilitated by the Copenhagen film agency. The agency contributes to the development of policy at the EU level, in addition to its work at the national level.

8. Recommendation Seven: Enhance Organizational Structure

8.1. Industry Advisory Committee

Of critical importance to the ability to ensure the Government's policy, program, and funding decisions will meet the needs of the industry, would be the formation of an advisory body to provide counsel to OMDC and the Government. The advisory counsel role would be to offer advice and recommendations on Government policy initiatives and Agency actions so as to bring policy and funding decisions more inline with industry needs. The creation of such a Committee would be a major step toward creating a stronger, working partnership between industry, government, and OMDC. Such an advisory group would foster increasing confidence in sector policy initiatives, giving the Government at a policy level and OMDC at an operating level, the industry support and insight needed to be successful.

The Industry Advisory Committee should consist of membership that represents the various elements of the production community, including Film, TV production, Digital Media, and take into account size (e.g. from independent producers to large Entertainment and Media companies) and genre diversity as well.

Mandated Authority

The Industry Advisory Committee would need a defined mandate to provide comment, concerns, and recommendations regarding policy initiatives and policy implementation.

As it would be an industry body, the industry should have the ability to propose members that would form the advisory body. In addition, there would also need to be a formal response mechanism to Committee concerns and recommendations to ensure industry needs are being considered.

Scope of Responsibilities

The Industry Advisory Committee would be responsible for the following:

- Recommending and making comment on policy, programs and initiatives to be taken or considered by Government or OMDC;
- Representing the needs of the sector to policy makers and the Agency responsible for operationalizing decisions; and

- Working with OMDC/Government to ensure programs are working as needed and recommending ways to make enhancements.

Challenges

For an Industry Advisory Committee to be effective, it has to have a role that is seen as a key influencer of the decision making process, and not as an adjunct to it. This would require achieving buy-in from the Government and/or OMDC for the committee, and willingness on their respective parts to work with and listen to the advisory body.

Creating the terms of reference for the advisory committee will be a challenge. There is a need to create a selection process, functional list of responsibilities, etc, which will have the support of the industry and the support of the Government/OMDC.

Timeframe

It is recommended that the Industry Advisory Committee be initiated in the near future, with the understanding that the Committee will be able to provide comment and assistance with the balance of the recommendations.

8.2. Enhanced Government Agency

The screen-based industry sector is complex, and the integrated Toolkit of programs outlined above reflects this fact. Differing components will be relevant to different projects and different times, not to mention evaluation of projects and possible supports that will need to be flexible and in line with a diverse range of production schedules. In order for the Toolkit to be effective, it is essential that OMDC have the required funding and administrative resources in place to implement the programs. This requirement includes program leaders with a background in industry and with expertise in the program areas outlined above. They would need to be able work with the Industry Advisory Committee and other industry participants in order to develop the mechanisms to implement and successfully operationalize the Toolkit programs.

Understanding that the screen-based industry sector is an integral part of the E&CC, there is also a need to consider strengthening OMDC's mandate and authority so that it can harness the resources and funding needed to manage, expand, and grow opportunities in the Province in a way that will ensure the long-term sustainability of the sector.

This new evolution of support could be the driving force needed to “electrify the sector” in Ontario, which could in turn foster a new era of innovative production activity, and the resulting employment opportunities associated with such a reinvigorated industry.

Requirements of an Expanded Mandate

An enhanced OMDC would become a champion and a leader for the industry in Ontario. To take on such a role, it would require a specific mandate to foster a major advancement in the Province's screen-based industry sector. Through this mandate, the Agency would be able to concentrate in a focused way on the needs of the industry and on creating an atmosphere conducive to growth – both culturally and economically. OMDC would have the mandated flexibility to chart new paths to foster innovation, and to coordinate the province's response to ever-changing challenges (e.g. an appreciating Canadian dollar, new Federal initiatives, new guidelines by the CTF board). It would also have the capacity and resources to encourage innovation across the E&CC, and the power, support, and funds to operationalize policy, advocate on behalf of the sector, create a marketing brand that would establish a position for the industry, and support research and innovation in the sector.

Scope of Responsibilities

The revitalized OMDC would continue to administer the Government of Ontario's existing production tax credit programs while also being tasked with managing and administering the other sector-specific government programs as described earlier in this report according to guidelines created in tandem with Government and industry experts. The Agency would also work with the sector and the Industry Advisory Committee, to explore new opportunities to address new issues that arise.

Using a "private-public partnership" approach to key initiatives, the Agency would drive further innovation through an ongoing dialogue with industry participants, financiers, and other agencies (i.e., SODEC/FIDEC). OMDC could also investigate and promote awareness of all financing options available to production companies (granting programs, development financing, Gap financing, interim financing, early stage interim financing, completion bonding, and targeted ancillary support).

Operationalization of the New Mandate

The screen-based industry unit within OMDC would be tasked with engaging industry stakeholders, both through the Industry Advisory Committee and broader based consultations to formulate a practical approach to designing programs and funding mechanisms.

OMDC would also control and have authority over the day-to-day management of any related programs and initiatives created for the sector, subject to pre-agreed decision-making criteria and with appropriate controls for public funds.

Finally, OMDC would also play a role in coordinating the relationship between Ontario Government ministries with an interest in, responsibility to, and/or policy objectives involving the sector, and operationalizing such policy.

To operationalize its expanded mandate, it is important for the enhanced OMDC to draw upon the talents of individuals with strong industry expertise. The addition of staff with comprehensive sector-specific experience would be beneficial and strengthen the ability of the OMDC to effectively operationalize programs and ensure that the marketing, networking, and other industry activities are being performed most effectively. Best practices in good governance exist and should be utilized when implementing new programs. As the “knowledge centre” and “advocate” of the industry, OMDC would be required to act as a comprehensive liaison for industry participants. Only staff with a strong foundation from within industry would be able to provide this. The outsourcing of specific functions, such as market surveys and intelligence may be required.

Challenges

The repositioning of OMDC would need the complete support (e.g. funding, mandated accountability, and responsibility) of the Government of Ontario, up to and including seed money for programs, especially those revolving around financing of industry productions. This repositioning would include making all the necessary changes to legislation to allow OMDC to act on its revised mandate.

This initiative would also need to develop cooperative relationships on a wide range of levels, both within the industry in terms of other financing sources, and abroad in terms of developing opportunities and attracting/developing sustained interest in the sector. Such relationship-building will take both time and experienced human capital. Additionally, it may be challenging to achieve buy-in for a private-public partnership approach toward leveraging the needs of the industry.

If OMDC is tasked with a cross-functional coordinating role, it would be at the centre of intense lobbying on the part of relevant industry stakeholders, and would need to work with the Government and the Industry Advisory Committee to develop acceptable, structured methods of determining how such funding should be distributed - either directly, or through agreements with separate entities (i.e., broadcasters, distributors).

Cost

There would likely be an additional cost associated with the operationalization of the expanded mandate of the OMDC. This cost has not been discussed in this report as it is possible that OMDC could take advantage of internal efficiencies and organizational support to implement its new mandate. Additions to the OMDC would best be handled directly through the operational budget of the

OMDC as opposed to through industry-specific funding proposed within this report. It is likely that the recruitment of qualified staff, beginning with the new executive director, would entail budget increases commensurate with the strengthened mandate and the additional funds to be administered by the Agency.

9. Conclusion

9.1. Overview

Increased Government support is essential to create an environment that will allow the screen-based content creation industry to grow in an economically viable and sustainable way. Government support, by itself, is not enough. Content creators must be able to generate higher revenue levels from the sale or licensing of copyright in the materials they create. This approach implies the need for better quality productions, new cross-platform revenue streams, and more aggressive and effective marketing both within Canada and in international markets.

We have therefore proposed a series of integrated and interrelated Government of Ontario programs that collectively form a Toolkit designed to create the environment that would allow these higher revenue levels to be achieved. The diagram below visually depicts how the programs in this Toolkit fit within the typical project lifecycle and the impact they would have on the companies within the industry.

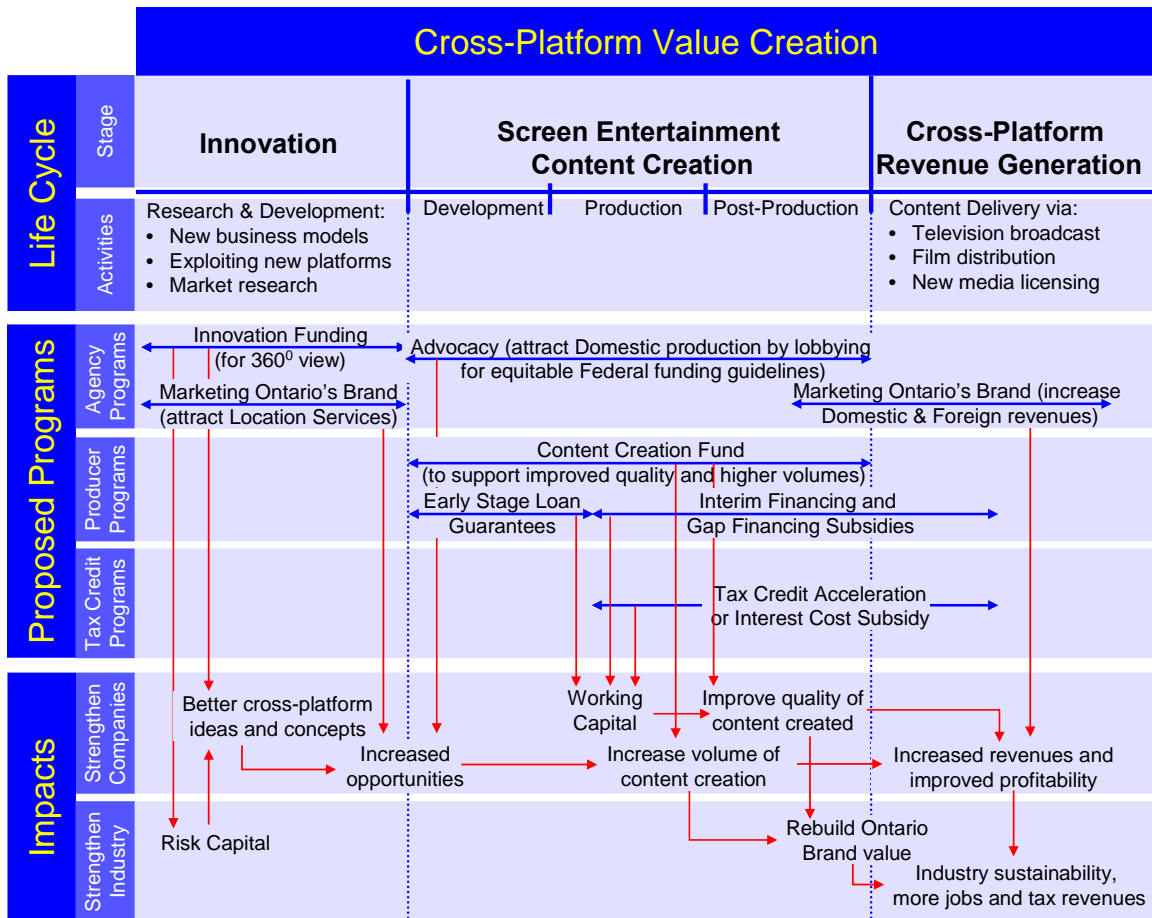


Figure 1 – Recommendations and Benefits

Screen-based content production companies must be stronger financially in order to be able to exploit these opportunities. Too often, production opportunities are lost or delayed due to timing issues on receipt of the various sources of financing needed to complete their productions. Through Recommendation One: Build Stronger Cross-Platform Companies and Recommendation Two: Finance Screen-Based Industry Tax Credits, we have proposed a number of programs that will accelerate and strengthen the cash flow and working capital positions of these companies, and provide them with additional capacity to take on more work. By accelerating this cash flow, content producers will also be able to increase development and production budgets, which are crucial in generating high-quality content.

In order to demonstrate the kind of project that will deliver superior returns to the Province, we put forward Recommendation Three: Improve Cross-Platform Content Quality and Volumes. Implementation of this recommendation would mean that OMDC can set up a demonstration program, where companies are awarded for “360” thinking and international success of rights exploited. The outcome of the proposed new direct Provincial funding would be increased quantity and quality of Ontario productions.

Advocacy funding is needed to reduce or eliminate barriers to Ontario production created by Federal funding programs that may inhibit Ontario projects.

Recommendation Four: Advocacy Program together with marketing programs to promote Ontario's "Brand" as a screen-based content partner will result in more opportunities for both Domestic and Foreign Location Services productions.

With increased volumes of higher quality product, Recommendation Five: Brand and Market the Screen-Based Industry provides new funding of marketing programs to promote Ontario-produced screen-based content both domestically and in foreign markets.

Innovation funding is needed to assist the industry in developing new business models, identifying ways to exploit new and emerging content delivery platforms, and developing new markets for Ontario content. Recommendation Six: Encourage Research and Innovation will result in the development of better cross-platform concepts and ideas, and a larger potential audience for this content.

An invigorated OMDC is needed as a champion and a leader for the screen-based industry in Ontario. Recommendation Seven: Enhance Organizational Structure provides OMDC with an enhanced capability to champion the industry.

Taken together, this package of programs will promote innovation, new revenue streams, better quality productions, and therefore should result in higher overall revenues per production dollar. We have proposed that this new funding be targeted towards the more commercially viable companies and projects, being those are expected to generate revenues 20% higher than the current industry average. Our financial models indicate that at this level of revenue and Government support, the industry will be positioned to grow and prosper in a sustainable way, generating more jobs and revenue for the Ontario economy.

Appendices

Appendix A: Economic Models

Two economic models were developed to allow us to estimate the economic effects of our recommendations on the industry, the Government of Ontario, and the Ontario economy:

- An Industry Model; and a
- Macroeconomic Model.

Descriptions of the two models, including basic assumptions are included in this section.

Industry Model

To facilitate the analysis of the current state of the Ontario screen-based industry, and estimate the impact of our recommendations on the industry, we developed an economic model based on:

- A pro-forma view of the industry in profit/loss format;
- Estimates of the impact of implementation of each recommendation on the profit/loss of the industry; and
- A pro-forma view of the industry after the implementation of all recommendations.

Column A in Figure 2 is a pro-forma or estimated baseline of the Film and Television industry using information from several sources. Column A estimates the revenue, production costs, net income and equity financing for Ontario film and television producers. Due to unavailability of relevant statistics for interactive media content producers (producers working with film and television productions), Column A does not include these interactive media content providers. The modeling challenge for Film and Television was due to the lack of sufficient information about the profitability of the industry from a single source. To respond to this challenge, we used information from several available sources, including sources of film and television financing from the CFTPA's publication *Profile 2006: An Economic Report on the Canadian Film and Television Industry* and from OMDC's Annual Reports for the years 2002/03, 2003/04 and 2004/05. Neither of these sources addresses the issue of aftermarket revenues, so we created estimates by leveraging Telefilm data about its investments in Film and Television productions, and extrapolating the applicability of this data to non-Telefilm funded productions.

Columns B through E in Figure 2 show the estimated impacts of implementing each of the Ontario Screen Fund recommendations. The estimated revenues for each of these recommendations assume a 20% increase in revenue per production dollar above current levels. We have proposed that this 20% threshold be applied as one of the selection criteria for these programs, in order to focus support on more profitable productions. This in turn is expected to focus producers on cross-platform revenue sources, and production of higher quality, marketable content in order to achieve this revenue threshold. Based on our analysis of production funding patterns, we have estimated that the incremental public funding will generate roughly double the amount of production spend, together with incremental impacts on other public and private sources of funding. With respect to column D specifically, we have determined the amount of early stage loans and therefore the incremental production spend that the new Government funding will support, by applying an expected 5% loan loss rate and a 2% bonding rate to the available amount of new Government funding. We also assumed that "early stage" production spending is roughly 35% of total production costs, so that this new production spend actually benefits approximately \$123 million in productions in terms of revenue generation capabilities.

This is why revenue as a percent of production spend is higher for this program than in others.

Columns G through I in Figure 2 reflect the estimated impact on content producers of Growing Sector Strength, Recognition and Leverage. These are sector-specific programs. To be conservative, we have not assumed any incremental production spend flowing directly from these programs, and that the primary benefit to producers will be in terms of helping them to achieve the 20% higher revenue ratio already reflected in the Ontario Screen Fund (columns B through E).

Columns J and K in Figure 2 show the estimated impact on producers of two options for fixing the issue of the timing of tax credit payments. Column J shows the estimated impact of advancing the OFTTC tax credit payments all at once. For this purpose we have assumed that payment of tax credits is accelerated by approximately 18 months, resulting in a one time impact of 1.5 times the annual tax credit payments. Column K shows the estimated impact of subsidizing the cost to finance the tax credit. The net benefit to producers in either case is identical, essentially the interest they would save over an 18 month period on loans they currently use to finance these tax credits until received.

Column L in Figure 2 shows a pro-forma view of the industry after the implementation of all the recommended programs. This is derived from the combination of the pro-forma industry baseline in Column A and the cumulative estimated impacts of all recommendations.

Summary of Government Expenditures, Revenues and Industry Benefits

(all figures in \$ millions)	Year					Total
	1	2	3	4	5	
<u>Government Expenditures</u>						
1. Ontario Screen Fund	33.6	33.5	33.5	33.4	33.3	167.2
2. Growing Sector Strength, Recognition and Leverage	5.0	5.0	5.0	5.0	5.0	25.0
3. Screen Based Industry Tax Credits						
- Option A: Accelerate Tax Credits for all Eligible Productions	135.9	-	-	-	-	135.9
- Option B: Sfunding for Interest Costs Associated with the Tax C	10.2	10.8	11.5	12.1	12.9	57.5
Total Government Expenditures - Option A	174.5	38.5	38.5	38.4	38.3	328.2
Total Government Expenditures - Option B	48.8	49.3	49.9	50.5	51.2	249.7
<u>Government Revenues</u>						
1. Ontario Screen Fund	24.1	24.1	24.1	24.1	24.1	120.3
2. Growing Sector Strength, Recognition and Leverage	2.2	4.3	6.5	8.7	10.8	32.5
3. Screen Based Industry Tax Credits	2.2	2.3	2.5	2.6	2.8	12.5
Total Government Revenues (same for either Option)	28.4	30.7	33.0	35.4	37.7	165.2
Net Impact to Treasury - Option A	(146.0)	(7.8)	(5.4)	(3.0)	(0.6)	(162.9)
Net Impact to Treasury - Option B	(20.3)	(18.6)	(16.9)	(15.2)	(13.5)	(84.5)
Gross Provincial Product Impact	218.7	236.4	254.1	272.0	289.8	1,271.0
<u>Employment Impacts</u>						
Employment - Direct - Person years of employment	1,223	1,337	1,451	1,566	1,681	7,259
Employment - Indirect - Person years of employment	1,947	2,129	2,311	2,494	2,678	11,559
Total	3,170	3,466	3,763	4,060	4,359	18,818

Figure 3 – An Illustration Using the Macroeconomic Model

Macroeconomic Model

In order to facilitate the analysis of the impact of our recommendations on the Government of Ontario and the Ontario economy in general, we developed a macroeconomic model (an illustration using the macroeconomic model is shown in Figure 3 above) based on:

- The estimated impact on the recommendations on industry production spending;
- The estimated economic uplift to Ontario from increases in production spending as measured by:
 - Gross Provincial Product (GPP), and
 - Employment, both direct and indirect; and
- The estimated impact on the Government of Ontario treasury, considering both increased Government expenditures on the recommendations and increased Government revenues from incremental increases in GPP.

The macroeconomic model was developed to estimate the above impacts over a five-year period using the following assumptions (from the Ernst & Young study of tax credit impact commissioned for FilmOntario in 2004, *Losing Its Lustre – The Decline of Ontario’s Film Industry*):

- A 6% annual growth rate was assumed for:
 - The loan volume for the Interim Finance Costs Program;
 - The loan volume for the Gap Finance Costs Program; and
 - The tax credit volume.
- Legal fees estimated at \$17,000 per loan for the Interim Finance Costs Program and the Gap Finance Costs Program;
- Set-up fees of 1% of loan volume for the Interim Finance Costs Program, and 1.875% for the Gap Finance Costs Program;
- That the amounts subsidized in the recommendations are invested in screen production using a multiplier of 2.02 (ratio of incremental production volume to subsidized amount);
- The impact of incremental production spending on GPP is estimated using a multiplier of 2, with a leakage rate outside the province of 5% for domestic production and 20% for foreign location services production;
- Incremental tax revenue as a result of incremental GPP is estimated at 13%;

- Incremental production spending of \$1 million has estimated employment benefits of:
 - 10.4 person-years of direct (industry) employment
 - 16.6 person-years of indirect employment
- Loan losses for the Loan Guarantee program are estimated at 5% of the loan amount, given that short-form contracts will be in place and a bonding company will be engaged to ensure project completion; and
- Bonding company fees for the Loan Guarantee program are estimated at 2% of the amount guaranteed.

Appendix B: An Illustration to Reposition the Cluster

The purpose of this illustration is to show a hypothetical example of how targeted investments outlined in the recommendations section of this report would assist in repositioning the E&CC economically.

According to our model, targeted investments would increase production and improve revenue. Improved revenue comes from:

- Improved content quality and marketability;
- The addition of digital media revenue streams to film and television projects;
- The addition of film and television content to digital media projects; and
- Improved producer negotiating position obtained from an improved cash-flow position.

The following is a single example of how this repositioning can be accomplished. All information in this illustration was derived using the PricewaterhouseCoopers economic model (See Appendix A). Depending on the allocation of spend per program, the model could be adjusted accordingly.

Ontario Screen Fund

An Ontario Screen Fund with annual resources of \$30 million could allow the Ontario E&CC to change the dynamic toward a more self-sustaining industry sector. The Fund, addressing Recommendations One and Three, would consist of four individual programs and be the centerpiece of the Toolkit. It would be geared toward assisting cross-platform companies build stronger balance sheets through increased working capital and should lead to more up-front investment in concept development and innovation, resulting in improved cross-platform content quality and increased production volumes.

The Fund's four program elements would be aligned with each of the two overall objectives of the fund:

- A Loan Guarantee program, an Interim Finance Cost Program and a Gap Finance Cost Program would be directed toward building stronger cross-platform companies; and
- A Content Creation Fund would be directed toward improving cross-platform content quality and growing production volumes.

These individual programs, outlined in the following sections, should build on the availability of other funds currently provided in the Province, including OMDC's television and interactive digital media funds and the Ontario Ministry of Culture's Partnership fund of \$7.5 million. Over time, however, all funds could be integrated under the Screen Fund to ensure Ontario screen-based companies have the means to fully leverage cross-platform opportunities and increase the quality content of their products for distribution.

\$30 million per year is provided by the Government of Ontario for this Screen Fund. In our example, the Fund is directed as follows:

1. \$7.8 million per year for the Interim Finance Costs Program (Column B, Row 18 in Figure 2 above).

- 1.1. The assumptions made during the development of the economic model developed for this project with regard to the Interim Finance Costs Program, include:

- 1.1.1. The total loan value for early interim financing will be \$97 million annually (in Year 1) consisting of approximately 400 loans (consistent with recent production volumes), with a growth rate of 6% per year, split equally between growth in the number of loans and growth in the average value of the loans;

- 1.1.2. Legal fees are assumed to be \$17,000 per loan; and

- 1.1.3. Set-up fees are assumed to be 1% of loan amount.

2. \$0.6 million per year for the Gap Finance Costs Program (Column C, Row 18 in Figure 2).

- 2.1. The assumptions made during the development of the economic model with regard to the proposed Gap Financing Costs Program, include:

- 2.1.1. We estimate the total loan value for Gap financing in Ontario to be \$18 million annually (consisting of approximately 18 loans) in Year 1, growing at an annual rate of 6%.

- 2.1.2. Legal fees are assumed to be \$17,000 per loan.

- 2.1.3. Set-up fees are assumed to be 1.875% of loan volume.

3. \$3.0 million per year to support Loan Guarantees (Column D, Row 18 in Figure 2), comprised of Early Stage and Tax Credit Hold-Back Loan Guarantees.

3.1. The assumptions made during the development of the economic model with regard to the provision of Loan Guarantees, include:

3.1.1. Based on annual funding of \$3 million, we estimate that this program could support early stage loans totaling \$42.9 million annually.

3.1.2. Loan guarantee criteria (e.g. pre-sales thresholds) will be established to select productions that are expected to produce revenues that are 20% higher than the industry average, in order to focus assistance on marketable, commercially viable projects.

3.1.3. Loan losses are assumed to be 5% of loan value and bonding fees are assumed at 2% of loan value.

4. \$18.6 million per year for the Content Creation Fund (Column E, Row 18 in Figure 2)

Finance Screen-Based Industry Tax Credits

This is the implementation of Recommendation Two. The Government of Ontario could assist the industry by either:

- a) Advancing the tax credit; or
- b) Supporting the interest fees associated with production companies borrowing against the tax credit.

Either option (a) or (b) produces the same result for the industry and the Province. The only difference is the cost to Government. For our example, we selected option (b) in order to avoid the large one-time spend for advancing the tax credits (see Columns J and K, Row 1 in Figure 2).

1. The cost benefit analysis for the advancement of tax credits took into account a number of assumptions. In summary, these assumptions are as follows:

1.1. The tax credits to be advanced include:

- Ontario Film and Television Tax Credit;

- Ontario Production Services Tax Credit;
- Ontario Computer Animation and Special Effects Tax Credit; and
- Ontario Interactive Digital Media Tax Credit.

1.2. The interest savings will be available to producers as working capital for reinvestment in new screen productions (TV, Film, Digital Media, etc.).

1.3. The model estimates that production spend, and therefore tax credits, will grow at a rate of 6% per year.

Growing Sector Strength, Recognition and Leverage

In our example, Growing Sector Strength, Recognition and Leverage consists of Recommendations Four through Seven, providing following funding for sector-based initiatives:

- \$1 million per year for the Advocacy Program (Column G, Row 1 in Figure 2);
- \$2 million per year to Encourage Research and Innovation (Column H, Row 1 in Figure 2); and
- \$2 million per year to Brand and Market the Screen-Based Industry (Column J, Row 1 in Figure 2).

Cumulative Benefits from All Recommended Programs

Based on the model, the \$44 million in incremental Government funding (Column L, Row 1 in Figure 2) described above produces the following estimated benefits.

Incremental benefits to the industry:

- An increase in production spend from \$534 million to \$649 million (see Columns A and L of Row 14 of Figure 2).
- An increase in revenue from \$256 million to \$330 million (see Columns A and L of Row 10 of Figure 2).
- An increase in net income available to producers of \$31 million (see Columns A and L of Row 22 of Figure 2).

- An increase in the ratio of revenue to production cost for Film and Television from 48% to 65.5% due to requirements for improved content quality and cross-platform involvement of digital media associated with the Screen Entertainment Content Creation Finance Fund (see Columns A and F of Row 11 of Figure 2).
- Elimination of production company deferrals as a source of financing for the industry as a whole (down from \$17 million before new programs) (see Columns A and L of Row 25 of Figure 2).

Estimated benefits to the Province, over a five-year period (see Figure 3):

- An increase in direct employment of 7,259 person-years
- An increase in indirect employment of 11,559 person-years
- An increase in Gross Provincial Product of \$1.27 billion

The cost to the Government of Ontario, net of tax revenue effects, over a five-year period is estimated at \$84.5 million.